IN THE UNITED STATES COURT OF FEDERAL CLAIMS

Raymond G. Farmer, in his capacity as Liquidator of Consumers' Choice Health Insurance Company, and Michael J. FitzGibbons, in his capacity as Special Deputy Liquidator of Consumers' Choice Health Insurance Company, Plaintiffs, vs. The United States of America, Defendant.	)	Case No. 18-1484C Judge Campbell-Smith

PLAINTIFFS' RESPONSE IN OPPOSITION TO THE UNITED STATES' MOTION TO DISMISS THE COMPLAINT

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Plaintiffs Raymond G. Farmer, in his capacity as Liquidator of Consumers' Choice Health Insurance Company, and Michael J. FitzGibbons, in his capacity as Special Deputy Liquidator of Consumers' Choice (together "Plaintiffs"),[1] submit the following Memorandum in Opposition to Defendant the United States of America's (the "United States" or the "Government") Motion to Dismiss the Amended Complaint. (Dkt. No. 11.) Plaintiffs respectfully request a hearing in this matter on the Government's motion.

INTRODUCTION

Consumers' Choice, like every other health insurer formed under the Patient Protection and Affordable Care Act ("ACA"), relied on risk mitigation programs established in the ACA that involved a complex system of payments by the Government to insurers to minimize the risk of providing insurance to a previously uninsured population with unknown health risks. When the Government did not provide the funding promised in the ACA, Consumers' Choice failed and was ultimately placed into liquidation in the South Carolina Court of Common Pleas. Then, despite having caused Consumers' Choice's collapse by not making its required payments, the Government initiated a series of improper and self-dealing set-offs designed to wrongfully elevate its priority of payment from Consumers' Choice's estate at the expense of all other creditors and to the detriment of other South Carolina companies and taxpayers. Indeed, the Government seeks repayment of its debt before the citizens of South Carolina are repaid $37 million that they, acting through the South Carolina Life and Accident and Health Insurance Guaranty Association ("SCGA"), have expended to satisfy Consumers' Choice's obligations.

[1] Plaintiff Farmer is the Director of the South Carolina Department of Insurance and was appointed Liquidator of Consumers' Choice by the Richland County Court of Common Pleas in the matter captioned as *Raymond G. Farmer, as Director of the S.C. Dept. of Ins. v. Consumers' Choice Health Ins. Co.* (No. 2016-CP-40-00034). Plaintiff FitzGibbons is the Special Deputy Liquidator of Consumers' Choice, appointed by the Richland County Court of Common Pleas in the same matter.

Accordingly, Plaintiffs brought this action seeking damages arising from the Government's actions as such actions violate the terms of the ACA, the terms and requirements of express and implied contracts entered by Consumers' Choice and the Government, South Carolina law, the Fifth Amendment to the Constitution, and the Presidential Executive Order entered on January 20, 2017 requiring the federal government to exercise all authority and discretion to waive and defer any provision of the ACA that would impose a fiscal burden on any State.

The Government has moved to dismiss Plaintiffs' Complaint. For the reason outlined below, the Government's Motion fails and must be denied.

STATEMENT OF THE ISSUES PRESENTED

(1) May the Government set off Reinsurance funds owed to Consumers' Choice against repayment of the Start-Up Loan when the Government affirmatively, contractually subordinated its repayment rights below those of other creditors?

(2) May the Government set off repayment of the Start-Up Loan, which is most accurately characterized as equity or a capital contribution, against the Reinsurance amounts owed to Consumers' Choice?

(3) May the Government excuse its statutory violations by claiming they were merely permissible offsets when, in fact, such offsets were not permitted by federal or state law and, rather, were forbidden by applicable law?

(4) May the Government excuse its breaches of express and implied contracts and the covenants therein by claiming HHS/CMS had no obligation to comply with the contracts' terms and the contracting parties' reasonable expectations?

(5) May the Government's violations of state law be addressed and decided by this Court, especially when the Government previously convinced the District of South Carolina to dismiss such claims on the basis that they could be decided by this Court?

(6) May the Government take Consumers' Choice's property without just compensation in violation of the Fifth Amendment to the United States Constitution?

STATEMENT OF THE CASE[2]

I. Consumers' Choice is formed.

Consumers' Choice was one of 23 Consumer Oriented and Operated Plans ("CO-OPs") created under the ACA and certified by the Centers for Medicare & Medicaid Services ("CMS")—an operating division of the United States Department of Health and Human Services ("HHS")—as a Qualified Health Plan ("QHP") to participate on the ACA exchanges. On March 27, 2012, HHS/CMS and Consumers' Choice closed on a Loan Agreement (Ex. A to Compl., Dkt. No. 1-1) that included Promissory Notes for a Start-up Loan to Consumers' Choice in the amount of $18,709,800 (the "Start-up Loan") and Solvency Loans to Consumers' Choice in the amount of $68,868,408 (the "Solvency Loan"). Consumers' Choice received the Start-up Loan and Solvency Loan from HHS/CMS pursuant to 42 U.S.C. § 18042(b)(1)(A)–(B) and the Loan Agreement. Consumers' Choice received its certificate of authority from the South Carolina Department of Insurance on May 2, 2013 and began operating as a non-profit mutual benefit corporation under South Carolina law.

On September 11, 2013, Consumers' Choice and CMS entered into a Qualified Health Care Plan Issuer Agreement regarding Consumers' Choice's provision of insurance in calendar year ("CY") 2014 and the payment of various amounts between Consumers' Choice and CMS. *See* 2014 Qualified Health Care Plan Issuer Agreement (the "2014 QHP Agreement," Ex. B to Compl., Dkt. No. 1-2). Consumers' Choice first offered health insurance to individuals and groups during the "open enrollment" period beginning October 1, 2013, for coverage effective January 1, 2014.

[2] A full discussion of the relevant facts at issue in this case is set forth in Plaintiffs' Complaint, Docket No. 1. The material facts regarding the enactment of the ACA and history of the 3Rs program do not appear to be in dispute. However, to the extent there is a conflict, the Court must accept as true the facts as pled by Plaintiffs in their complaint at the motion to dismiss stage.

On October 28, 2014, pursuant to § III.B of the 2014 QHP Agreement, Consumers' Choice and CMS renewed the QHP Agreement to extend through CY 2015 (the "2015 QHP Agreement," *see* Ex. C to Compl., Dkt. No. 1-3). As of October 2015, Consumers' Choice had approximately 67,000 participating members. Over the course of its operations, Consumers' Choice participated in and upheld its obligations under the ACA's Reinsurance, Risk Adjustment, and Risk Corridor programs (the "3Rs" as the ACA's risk mitigation provisions are colloquially known).

II. Consumers' Choice experiences financial distress.

On or about October 1, 2015, Consumers' Choice was informed by CMS that Consumers' Choice would receive only 12.6% of the Risk Corridor payments it was scheduled to receive for 2014 and which should have been paid in full in 2015. CMS represented to Consumers' Choice that the remaining 87.4% would be paid in subsequent years based on collections and funding.

CMS later informed the South Carolina Department of Insurance that Consumers' Choice would not receive any of the remaining Risk Corridor payments it was owed for 2014. This resulted in Consumers' Choice having to non-admit the promised full Risk Corridor payment because it was no longer qualified as an admitted asset and is required by statutory accounting principles to be non-admitted. Consequently, Consumers' Choice risk-based capital ("RBC") ratio dropped from 877% as of December 31, 2014 to an amount at or below the regulatory action level.

On October 20, 2015, CMS advised that any additional federal funds to Consumers' Choice would be extremely unlikely. Without the Government's promised funds, Consumers' Choice's premium structure would not be sufficient to support its ongoing operation.

III. Consumers' Choice undergoes rehabilitation and then liquidation in South Carolina state court pursuant to the state Liquidation Act.

The South Carolina Insurers Rehabilitation and Liquidation Act ("the Liquidation Act") governs the rehabilitation and liquidation process and proceedings for Consumers' Choice. On

October 21, 2015, Raymond G. Farmer, as Director of the South Carolina Department of Insurance, and Consumers' Choice entered into a consent order placing Consumers' Choice into supervision. On October 22, 2015, Consumers' Choice agreed to wind down its operations. On January 6, 2016, Consumers' Choice's Board of Directors consented to a rehabilitation of its business. On January 8, 2016, the Richland County Court of Common Pleas, acting pursuant to the Liquidation Act, entered an order placing Consumers' Choice into rehabilitation (the "Rehabilitation Order"). The subsequent efforts of Plaintiffs Farmer and FitzGibbons to rehabilitate Consumers' Choice proved futile.

On March 28, 2016, the Richland County Court of Common Pleas, again acting pursuant to the Liquidation Act, filed an order placing Consumers' Choice into liquidation (the "Liquidation Order," attached hereto as **Exhibit A**). The Liquidation Order stated the Liquidator and his designees were authorized to institute suits and other legal proceedings and to collect all debts and monies due and claims belonging to Consumers' Choice. The Liquidation Order also provided as follows:

> 5. PURSUANT TO S.C. Code Ann. §§ 38-27-70 & -430 (2015) and the Rehabilitation Order, Notice is hereby given that the permanent automatic stay and injunction applicable to all persons and proceedings, other than the Receiver, shall remain in full force and effect and survive entry of this Order.

See Liquidation Order (attached as Ex. A) at 9.

IV. The Government fails to pay amounts owed to Consumers' Choice under the ACA's Reinsurance program.

Under the ACA and HHS's implementing regulations, Consumer's Choice is owed $36,976,345 under the Reinsurance program for the 2015 policy year. Despite its statutory mandate and assurance to pay 100% of this payment, HHS/CMS has failed to pay the amounts it owes to Consumers' Choice for the 2015 policy year. Indeed, despite being owed $36,976,345

under the Reinsurance program for policy year 2015, Consumers' Choice has been paid $0. In the Spring of 2016, shortly after Consumers' Choice was placed in rehabilitation and then liquidation, CMS made early reinsurance payments to other insurers for the 2015 policy year, but did not make any payment to Consumers' Choice.

On March 8, 2016, Consumers' Choice received a letter from CMS stating CMS had placed an administrative hold on amounts payable to Consumers' Choice. The amounts in question included $30.6 million owed to Consumers' Choice under the Reinsurance program at that time.

Further, HHS/CMS has repeatedly, and unilaterally, held or reduced payments owed to Consumers' Choice based on debts that HHS/CMS claims Consumers' Choice owes to HHS/CMS. For instance, by letter dated August 11, 2016, CMS unilaterally and without notice advised Consumers' Choice that it had offset approximately $21.7 million of Reinsurance balances due Consumers' Choice against balances alleged to be due CMS by Consumers' Choice of $15.1 million in Risk Adjustments, $4.7 million in cost-sharing reduction amounts, and approximately $2.0 million in other balances. Similarly, by letter dated September 29, 2016, CMS advised Consumers' Choice that it had offset another $11 million of Reinsurance due to Consumers' Choice by amounts alleged to be owed to CMS by Consumers' Choice on the Start-up loan. By letter dated January 19, 2017, CMS advised Consumers' Choice that it had offset another $2.2 million of Reinsurance and Risk Corridor balances due Consumers' Choice against balances alleged to be due CMS by Consumers' Choice of approximately $1.4 million on the Start-up Loan and approximately $745,000 in other balances. Finally, by letter dated March 31, 2017, CMS advised Consumers' Choice it had offset another $2.3 million of Reinsurance balances due to Consumers' Choice against balances alleged to be due CMS by Consumers' Choice of that amount on the Start-Up Loan.

V. Recent developments support the conclusion that Consumers' Choice is entitled to the relief it seeks from this Court.

On January 20, 2017, the President of the United States issued an Executive Order entitled *Minimizing the Economic Burden of the Patient Protection and Affordable Care Act Pending Repeal* (the "Executive Order"), whereby it was ordered:

> To the maximum extent permitted by law, the Secretary of Health and Human Services (Secretary) and the heads of all other executive departments and agencies (agencies) with authorities and responsibilities under the [ACA] *shall exercise all authority and discretion available to them to waive, defer, grant exemptions from, or delay the implementation of any provision or requirement of the [ACA] that would impose a fiscal burden on any State*. . . ."

Executive Order 13765 (Jan. 20, 2017) (emphasis added), *available at* https://www.federalregister.gov/documents/2017/01/24/2017-01799/minimizing-the-economic-burden-of-the-patient-protection-and-affordable-care-act-pending-repeal.

STANDARD OF REVIEW

Consumer's Choice agrees with the standard of review set out in the Government's motion.

ARGUMENT

The Government's motion raises numerous arguments requiring the resolution of disputed issues including whether state or federal law permits the Government's offsets; whether the state court liquidation proceeding and Liquidation Order curtail the Government's offset rights; whether the Government entered and breached express and implied-in-fact-contracta or implied covenants; and whether this Court has jurisdiction over certain claims. Consumers' Choice responds to each of these arguments below. For the sake of analytical simplicity, however, Consumers' Choice begins with the two arguments that—regardless of the outcome of the others—require dismissal of the Government's pending motion. First, regardless of whose law controls, what it permits, and what it prohibits, the Government contractually agreed that its right to repayment of the Start-Up

Loan was subordinate to the payment rights of other claimants. The Government's subsequent offsets violated this contractual subordination, thus the Complaint asserts a claim on which relief can be granted. Second, regardless of the outcome of any other issue or argument, the Government's purported offsets were impermissible because the Start-Up Loan was, in fact, either equity or a capital contribution, and thus repayment of the Start-Up Loan cannot be offset against the Reinsurance amounts owed to Consumers' Choice in the way the Government purported to do.

I. The Government affirmatively, contractually subordinated its repayment rights below those of other creditors, and the subsequent offsets breached this agreement.

Regardless of the outcome of any other issue or argument in the Government's pending motion, the Government's attempts to justify its offsets fail for an independent reason: namely, the Government's offsets violated HHS's voluntary, express, and affirmative contractual agreement to subordinate its repayment rights to the rights of other creditors.

The Complaint's fourth cause of action alleges HHS contractually agreed to subordinate its right to payment, including payment through offset, in the Loan Agreement, including its subsequent amendments, and subsequently breached that agreement by exercising offsets in violation of the Loan Agreement's terms. *Id*. at ¶¶ 92 and 128–36. Specifically, the Loan Agreement provides that both the Start-Up Loan and the Solvency Loan are "on par with the other for security purposes" and that both Loans "have a claim on cash flow and reserves of [Consumers' Choice] that is subordinate" to certain claims and expenses, as specified. (*See* Ex. A. to Compl., Loan Agreement, §§ 3.1 and 3.4.) Moreover, repayment of both Loans is "subject to Borrower's ability to meet State Reserve Requirements and other solvency regulations or requisite surplus note arrangements." (*See id.* at §§ 4.4 and 5.6.) Even in the event of the termination of the Loan Agreement, repayment must be made consistent with state insurance laws, and the Loan Agreement acknowledges that state insurance laws or regulatory action by a state insurance agency

or department may create an "actual legal impediment or restriction on repayment of Loan funds pursuant to the terms of this Agreement." (*Id.* §§ 15.3(c), 16.2, 16.3, and 2.1.)

In response, the Government argues (i) the Loan Agreement's "set-off" provision trumps its "subordination" provision, and (ii) that the "subordination" provision ceased to apply once Consumers' Choice was placed in liquidation. *See* Mot. to Dismiss at 24–25. Both arguments are incorrect. First, although the Loan Agreement provides for a right to offset "notwithstanding any other provision of this Agreement to the Contrary," this provision only purports that the Government "shall have at its disposal the full range *of available* rights, remedies and techniques to collect delinquent debts, such as those found in the Federal Claims Collection Standards . . . including . . . administrative offset." (*Id.* § 19.12 (emphasis added).) Any such offset right was only available following Consumers' Choice's payment of all policyholder claims. Further, such offset right was no longer available once Consumers' Choice entered rehabilitation and liquidation proceedings. Indeed, the Federal Claims Collection Standards, found in 31 C.F.R. Chapter IX, expressly note that administrative offset is not available to the Government once the debtor is involved in such a judicial proceeding. *See* 31 C.F.R. § 901.3(a) ("Collection by administrative offset") ("This section does not apply to . . . Offsets in the course of judicial proceedings, including bankruptcy.").

Furthermore, the Government's argument presents a false dichotomy by attempting to pit the Loan Agreement's subordination provision against its offset provision, arguing that one must trump or supersede the other. In fact, a better (and indeed, required) interpretation is to harmonize the clauses in a way that both can coexist. Such an interpretation is possible, and both clauses can (and should) be given effect. Specifically, Section 3.4 may be given effect by subordinating the Loan repayments to the three items enumerated in that section, and Section 19.12 can

simultaneously be given effect by allowing HHS to avail itself of the "available" rights and remedies, including offset, as to other amounts or when the default does not involve a judicial proceeding. Such an interpretation would give effect to both clauses, and better aligns with the ultimate purpose of the ACA, its CO-OPs, and the Loans, namely the protection of policyholders.

The Government's second argument to avoid the Loan Agreement's subordination provision is that the provision was supposedly a dead letter at the time HHS effected the purported offset. The relevant contractual provision states:

> Because the intent of the Loans, and the Solvency Loan in particular, is to provide financing to Borrower that meets the definition of "risk based capital" for State Insurance Laws purposes, the Loans will have a claim on cash flow and reserves of Borrower that is subordinate to (a) claims payments, (b) Basic Operating Expenses, and (c) maintenance of required reserve funds *while Borrower is operating as a CO-OP under State Insurance Laws*.

(*See* Ex. A. to Compl., Loan Agreement, § 3.4 (emphasis added).) The Government seizes on the italicized language to argue the contractual subordination was ineffective once the liquidation process commenced. Its argument suffers from numerous defects. To start, the Government simply assumes—without offering any argument, authority, or support—that an insurer is no longer "operating" once it begins the liquidation process, *i.e.*, that the process of winding down and liquidating (which includes payment of claims, collection of debts, payments creditors, etc.), is not a stage, albeit the final one, of an insurer's "operations." Neither the Loan Agreement, the ACA, nor the state Liquidation Act define "operating" for purposes of interpreting the Loan Agreement, and this Court may not simply assume—particularly at this stage of the proceeding—that "operating" means *only* pre-rehabilitation and pre-liquidation business activities and does not include activities taken as part of the rehabilitation and liquidation process.[3]

[3] These activities include the following, in which Consumers' Choice is still engaged today:

Further, even assuming *arguendo* that an insurer is no longer "operating" during the wind-down process, the language of the Loan Agreement's subordination provision continues to subordinate loan repayment to claims payments and operating expenses even after the initiation of rehabilitation and liquidation. As noted above, that provision states that loan payments are "subordinate to (a) claims payments, (b) Basic Operating Expenses, and (c) maintenance of required reserve funds *while Borrower is operating as a CO-OP under State Insurance Laws*." (*See* Ex. A. to Compl., Loan Agreement, § 3.4 (emphasis added).) The Government incorrectly assumes the italicized language applies to the *entire* subordination clause, rather than simply to subsection (c) in which it is found. A better interpretation is that the "loan" repayments are subordinated to claims payments and operating expenses both before *and* during the liquidation process (a process that is still ongoing for Consumers' Choice), but are not subordinated to reserve requirements during the liquidation process.

In addition, the Government's argument tacitly, and incorrectly, assumes Consumers' Choice was dissolved or was otherwise defunct at the time the Government exercised its purported offsets. But the Liquidation Order did not itself dissolve Consumers' Choice,[4] and the Liquidation Act states that if a court does not itself affirmatively dissolve the insolvent insurer, it will be dissolved only upon the discharge of the liquidator. *See* S.C. Code Ann. § 38-27-390. That has

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preparing and filing tax returns, preparing and filing financial statements with the state court, paying claims, pursuing subrogation and Provider refunds, engaging with the third-party administrator, and preparing and submitting reinsurance reporting to a third-party reinsurer. In short, the insurer still engages in nearly all of the same activities as prior to the rehabilitation and liquidation processes, save for accepting new risks.

[4] The Liquidation Order merely states that Consumers' Choice will be dissolved in the future upon the Liquidator's filing of a copy of the Order with the South Carolina Secretary of State. *See* Liquidation Order at ¶ 8 (attached hereto as **Exhibit A**). That filing has not yet occurred in light of the ongoing liquidation process, thus Consumers' Choice was not (and still is not) dissolved at the time of the "offsets."

not yet occurred, and a search of the South Carolina Secretary of State's online business database reveals Consumers' Choice is still a corporation in good standing and that no dissolution papers have been filed.

In sum, the Government contractually agreed to subordinate its rights to offset and to comply with applicable state law requirements. That contractual subordination did not lose effect upon initiation of the rehabilitation and liquidation process. Accordingly, even if the Government possessed a general common law or statutory right to offset under the facts presented (and it does not), that general right cannot be invoked as a means to circumvent a specific legal or contractual obligation. By claiming past and future offsets, the Government is attempting to unilaterally and improperly amend or repudiate the written Loan Agreement. The Government should not be allowed to avoid a contractual obligation; it contractually waived its right to offset with regard to the Start-Up and Solvency Loans.

II. The Start-Up Loan is more accurately characterized as equity or a capital contribution and thus cannot be offset against a debt.

Regardless of the outcome of any other issue or argument in the Government's pending motion (including the one discussed in the preceding Argument section), the Government's attempts to justify its offsets fail for an independent reason: namely, the Start-Up Loan is more accurately characterized as equity in, or a capital contribution to, Consumers' Choice, and thus it cannot be offset against a debt owed to Consumers' Choice. *See* Compl. ¶ 95. The proper character of the Start-Up Loan is expressly set forth in the Loan Agreement, which states "the intent of the Loan**s**"—plural, meaning the Start-Up Loan as well as the Solvency Loan—"is to provide financing to Borrower that meets the definition of 'risk based ***capital'*** for State Insurance Laws purposes." *See* Ex. A. to Compl., Loan Agreement, § 3.4 (emphasis added); *see also id*. at § 1.1 (noting in the "Statement of Purpose" that the funds were "for the purpose of financing start-

up costs and insurance reserves); *id*. at App. 1, Disbursement Agreement for Start-Up Loan Funds (same). Notwithstanding these express statements that the loan was meant as an infusion of capital, the Government argues the Start-Up Loan was a loan because (i) it is labeled thus in 42 U.S.C. § 18042(b)(1)(A), (ii) it supposedly "bears *all* the traditional indicia of a loan," and (iii) it has been described in various bookkeeping entries and financial statements as a liability. *See* Mot. to Dismiss at 19–20 (emphasis added). These arguments are incorrect as explained below.

As to the Government's first and third arguments, even when a transaction was labeled as a "loan" and has been booked as a debt, courts may place the proper label on an advance of funds as being either debt or equity, regardless of what the parties to the transaction called it. *In re Airadigm Communications, Inc*., 616 F.3d 642, 653 (7th Cir. 2010) ("Recharacterization is a theory, adopted by the overwhelming majority of courts to have considered the question, that bankruptcy courts may place the proper label of 'claim' (generally, debt) or 'interest' (equity) on an advance of funds, regardless of what the parties call it."). Indeed, "[i]n a case in which a creditor has contributed capital to a debtor in the form of a loan, but the loan has the substance and character of an equity contribution, the court may recharacterize the debt as equity . . . ." *In re Kids Creek Partners, L.P*., 212 B.R. 898, 931 (Bankr. N.D. Ill. 1997) (citing *Diasonics, Inc. v. Ingalls*, 121 B.R. 626, 630 (Bankr. N.D. Fla.1990)).

As to the Government's second argument—namely that the Start-Up Loan supposedly bears the indicia of a loan—the Court must examine the factors or indicia that identify a loan and inquire whether they are present here. *In re Merit Grp., Inc.*, 464 B.R. 240, 253 (Bankr. D.S.C. 2011). In determining whether to recharacterize a loan as an equity contribution rather than debt, courts consider the following eleven factors:

> (1) the names given to the instruments, if any, evidencing the indebtedness; (2) the presence or absence of a fixed maturity date and

> schedule of payments; (3) the presence or absence of a fixed rate of interest and interest payments; (4) the source of repayments; (5) the adequacy or inadequacy of capitalization; (6) the identity of interest between the creditor and the stockholder; (7) the security, if any, for the advances; (8) the corporation's ability to obtain financing from outside lending institutions; (9) the extent to which the advances were subordinated to the claims of outside creditors; (10) the extent to which the advances were used to acquire capital assets; and (11) the presence or absence of a sinking fund to provide repayments.

Fairchild Dornier GmbH v. Official Comm. of Unsecured Creditors (In re Dornier Aviation (*N. Am.*), *Inc.*), 453 F.3d 225, 233–34 (4th Cir. 2006). None of the factors are dispositive, but rather, the totality of the factors "are aimed at determining the intent of the parties at the time they entered into the loan transaction, which is the overarching inquiry in determining whether the true character of an investment is either a loan or an equity contribution." *Vieira v. AGM II, LLC (In re Worldwide Wholesale Lumber, Inc.)*, 372 B.R. 796, 811 (Bankr. D.S.C. 2007).

Here, the majority of the factors weigh in favor of the Start-Up Loan being characterized as equity rather than debt. For example, there is no fixed maturity date or regular schedule of payments;[5] at the time of the loan transaction, the "loan" lacked interest;[6] at the time of the loan transaction, Consumers' Choice was not capitalized at all; Consumers' Choice had no ability to obtain financing from outside lending institutions; repayment of the Start-Up Loan was ***subordinate to claims of outside creditors***; the advances were used to pay for Consumers'

[5] The Government incorrectly argues that the Start-Up Loan "has a fixed maturity date and repayment schedule." *See* Mot. to Dismiss at 19. This assertion is belied by the Record, including the very sources the Government cites. The statute establishing such loans, for example, merely states that "such loans shall be repaid *within* 5 years." *See* 42 U.S.C. § 18042(b)(3) (emphasis added). Likewise, the Loan Agreement states the Start-Up Loan amounts will be repaid "*no later than* 5 years from the respective Disbursement date of the individual Loan Disbursement installments, *subject to Borrower's ability* to meet State Reserve Requirements and other solvency regulations or requisite surplus note arrangements." *See* Loan Agreement § 4.4 (Dkt. No. 1-2) (emphasis added).

[6] *See* Loan Agreement App. 6 (Dkt. No. 1-2) (stating the Start-Up Loan's interest rate is "0.0%").

Choices' operating expenses and capital assets; and no sinking fund was established to provide for repayment of the "loan."

Moreover, the totality of the circumstances indicate the Start-Up Loan should be treated as equity rather than debt, because CMS was willing to convert Start-Up Loans into Solvency Loans, which CMS has recognized may be booked as an asset and characterized as a capital infusion. *See* Letter from CMS to CO-OP Project Officers, July 9, 2015 at 1 (attached hereto as **Exhibit B**) (noting CMS "will now allow CO-OPs to request that surplus notes be applied to Consumer Operated and Oriented Plan (CO-OP) Program start-up loans. Applying surplus notes to the start-up loans will enable CO-OP borrowers to record those loans as assets in financial filings with regulators.");[7] 45 C.F.R. § 156.520 (stating that Solvency Loans are required for the insurer to "maintain an amount of capital that is consistent with its size and risk profile;" and that Solvency Loans "will be structured in a manner that ensures that the loan amount is recognized by State insurance regulators as contributing to the State-determined reserve requirements or other solvency requirements (rather than debt)").

Because the Start-Up Loan should be treated as equity,[8] and because amounts owed to Consumers' Choice cannot be offset against equity in Consumers' Choice, the Government's purported offset was impermissible and cannot excuse the Government's failure to pay the

[7] Consumers' Choice requested such a conversion in writing sent to CMS on October 5, 2015. The conversion had not been effectuated by the time Consumers' Choice entered rehabilitation and, subsequently, liquidation processes.

[8] Consumers' Choice has alleged sufficient factual allegations to support recharacterization of the Start-up Loan. Under the relevant factors, the determination of whether a loan should be recharacterized is conducted on a fact specific, case-by-case basis, based on a careful balancing of numerous factors that is inappropriate on a motion to dismiss. *See In re AutoStyle Plastics, Inc.*, 269 F.3d 726, 731 (6th Cir. 2001); *Gladstone Bus. Loan, LLC v. Randa Corp.*, No. 09 CIV 4225 LMM, 2010 WL 4983263, at *4 (S.D.N.Y. Dec. 8, 2010) ("[I]nquiry as to whether an action is a debt or equity transaction is fact-intensive"); *In re Gluth Bros. Const., Inc.*, 424 B.R. 379, 395 (Bankr. N.D. Ill. 2009) (noting that recharacterization analysis is "largely factual determination").

mandatory reinsurance amounts owed to Consumers' Choice. The Government's interpretation that the "loan" was subject to offset undermines the overarching purpose of the Loan Agreement since such funds are not subject to offset. At the very least, the allegedly conflicting language gives rise to an ambiguity, which must be construed against the drafter (here, the Government). *United States v. Seckinger*, 397 U.S. 203, 216 (1970); *Turner Constr. Co. v. United States*, 367 F.3d 1319, 1321 (Fed. Cir. 2004). Likewise, this ambiguity presents questions of fact that cannot be resolved on a motion to dismiss. The Government's motion should be denied.

III. The Government cannot excuse its statutory violations by claiming they were merely permissible offsets.

Consumers' Choice's first and second causes of action allege the Government violated federal statutes and regulations by failing to make $37 million in mandatory reinsurance payments owed to Consumers' Choice for the 2015 policy year, and by exercising an offset and administrative hold in violation of federal and state law. *See* Compl. at ¶¶ 98–114. The Government does not deny it had a mandatory statutory obligation to pay reinsurance amounts due to insurers for the 2015 policy year,[9] nor does the Government deny that $37 million in such payments were, in fact, due and owing to Consumers' Choice. Rather, the Government argues it was excused from this obligation by its supposed ability to "offset" amounts owed to Consumers' Choice against amounts allegedly owed by Consumers' Choice. *See* Mot. to Dismiss at 16–21. This argument is incorrect for the reasons explained below.

[9] Indeed, in the Spring of 2016, shortly after Consumers' Choice was placed in rehabilitation and then liquidation, CMS made early Reinsurance payments to other insurers for the 2015 policy year. *See* CMS, *Summary Report on Transitional Reinsurance Payments and Permanent Risk Adjustment Transfers for the 2015 Benefit Year* at 9–10 (June 30, 2016) (noting that "CMS made early reinsurance payments for the 2015 benefit year to 483 insurers in March and April, 2016" at a 55.1% coinsurance rate), *available at* https://www.cms.gov/CCIIO/Programs-and-Initiatives/Premium-Stabilization-Programs/Downloads/June-30-2016-RA-and-RI-Summary-Report-5CR-063016.pdf. Consumers' Choice, however, received no such Reinsurance payment.

A. Federal law does not authorize offset under the facts presented here.

The Government argues that federal courts, in a variety of contexts other than the liquidation of an insolvent insurer, have recognized a general right to offset mutual debts, and, further, that the ACA's regulations also authorize the use of offset. *See* Mot. to Dismiss at 16–17. As explained below, the Government is incorrect, first because *state* law—not the ACA or federal case law in other contexts—controls the liquidation of insolvent insurers and prohibits the offset performed by the Government. Second, even if federal law controlled, neither the ACA nor the federal case law cited by the Government authorize setoff here because the amounts owed to and from Consumers' Choice were not mutual debts.

1. Federal law does not control the liquidation of insolvent insurers.

The Government's reliance on federal law to justify its purported offsets fails because state law—not federal law—controls the liquidation of insolvent insurers. The primacy of state law in this context is established by the McCarran-Ferguson Act, has been recognized by Supreme Court, and is acknowledged by the ACA itself. The interrelation between state and federal law in the context of insurer liquidation was discussed at length in *United States Department of Treasury v. Fabe*, 508 U.S. 491 (1993). In *Fabe*, an insurer had been declared insolvent, and a state trial court had appointed the Ohio Superintendent of Insurance to serve as liquidator. *Id*. at 494. The United States was the obligee on various bonds issued by the company, and thus filed claims in excess of $10.7 million in the state liquidation proceedings, arguing its claims were entitled to first priority under a federal statute. *Id*. at 595. The liquidator brought suit in federal district court seeking a declaration that the federal priority statute did not preempt the state priority statute, which placed the United States in the fifth tier of priority.

The Court noted the state statute could escape preemption only if the state statute was enacted to regulate insurance and thus fell within the scope of the McCarran-Ferguson Act. *Id*. ("In order to resolve this case, we must decide whether a state statute establishing the priority of creditors' claims in a proceeding to liquidate an insolvent insurance company is a law enacted 'for the purpose of regulating the business of insurance,' within the meaning of § 2(b) of the McCarran-Ferguson Act, 15 U.S.C. § 1012(b)."). The Court stated a statute is one that regulates the business of insurance if it is "'aimed at protecting or regulating this relationship [between insurer and insured], directly or indirectly.'" *Id.* at 501 (quoting *SEC v. National Securities, Inc*., 393 U.S. 453, 460 (1969)). The Court concluded the Ohio priority statute was intended to regulate the business of insurance and thus fell with the scope of the McCarran-Ferguson Act's reverse preemption:

> We hold that the Ohio priority statute escapes pre-emption to the extent that it protects policyholders. Accordingly, Ohio may effectively afford priority, over claims of the United States, to the insurance claims of policyholders and to the costs and expenses of administering the liquidation.

Id. at 493–94.

The Court's holding was grounded on the fact that the Ohio priority statute was found in a Chapter of the Ohio Code establishing "a complex and specialized administrative structure for the regulation of insurance companies from inception to dissolution," whose stated purpose was "'the protection of the interests of insureds, claimants, creditors, and the public generally.'" *Id*. at 494 (quoting Ohio Rev. Code Ann. § 3903.02(D)). In addition, the Court noted the state statute's intent was central to the enforcement of insurance contracts:

> The Ohio priority statute is designed to carry out the enforcement of insurance contracts by ensuring the payment of policyholders' claims despite the insurance company's intervening bankruptcy. Because it is integrally related to the performance of insurance contracts after bankruptcy, Ohio's law is one "enacted by any State for the purpose of regulating the business of insurance."

Id. at 504; *see also id*. at 505–06 ("The primary purpose of a statute that distributes the insolvent insurer's assets to policyholders in preference to other creditors is identical to the primary purpose of the insurance company itself: the payment of claims made against policies."). The South Carolina Liquidation Act, like the Ohio statute at issue in *Fabe*, is a complex and specialized structure for the dissolution and liquidation of insurers, and its intent was central to the enforcement of insurance contracts

Further, when Congress enacted the ACA, it was well aware of the McCarran-Ferguson Act, which ensures the supremacy of the states in the arena of insurance regulation. As detailed above, the Supreme Court recognized in *Fabe* that state laws protecting policyholder interests are laws that regulate the business of insurance and, as such, "reverse-preempt" federal law. In other words, when Congress enacted the ACA, it knew that the "default" was that state law controls insurance regulation, including liquidation. Nevertheless, Congress chose not to include a priority scheme within the ACA.

Moreover, in the ACA, Congress manifested clear and unambiguous intent to preserve and comply with state law in the event of insolvency of a CO-OP. First, the ACA includes an express provision, under a clause titled "No interference with State regulatory authority," which states: "Nothing in this title shall be construed to preempt any State law that does not prevent the application of the provisions of this title." 42 U.S.C. § 18041(d).

Further, Congress directed the Secretary of HHS to promulgate regulations "with respect to the repayment of [loans to CO-OPs] in a manner that is ***consistent with State solvency regulations and other similar State laws that may apply***." 42 U.S.C. § 18042(b)(3) (emphasis added). Additionally, in July 2011, CMS published proposed regulations implementing the ACA

and noted that insurer liquidation is typically handled under state law rather than federal law, stating as follows:

> State law establishes a variety of required regulatory actions if an insurer's RBC [risk based capital] falls below established levels or percent of RBC. These regulatory interventions can range from a corrective action plan to liquidation of the insurer if it is insolvent. Solvency and the financial health of insurers is historically a State-regulated function.

Proposed Rules, 45 C.F.R. Part 156, 76 FR 43237-01 (July 20, 2011) (emphasis added).

There were several comments submitted in response to proposed regulations regarding plans to avert insolvency, and HHS/CMS responded by noting: "In the potential case of insurer financial distress, a CO-OP follows the same process as traditional issuers and must comply with all applicable State laws and regulations." *See* Final Rules, Responses and Comments, 45 C.F.R. 156, E.6 and F (Dec. 13, 2011). In the final regulation, HHS/CMS addressed the comments only by including ways to "reduc[e] the risk of insolvency." HHS/CMS stated that "[m]ost of those who have expressed interest in the program are . . . likely to be viable because of their private support, healthcare experience, and business expertise." *Id*. at Section F, "Alternatives Considered."

Thus, the implementing regulations attempted only to "reduce the risk of insolvency," but made no attempt to regulate the process of liquidation of an insolvent insurer, which was left to the states. By recognizing and preserving the states' jurisdiction over any insolvency proceeding, the federal government, as the largest investor in the CO-OPs, consented to application of state law in relation to all aspects of the liquidation, including priority of claimants. Further, Congress did not express any intent, express or implied, to preempt state regulation of insurer insolvency, including in relation to the CO-OPs.

In sum, under the McCarran-Ferguson Act, *Fabe*, and the ACA itself, state law—namely, the South Carolina Liquidation Act—governs the priority of claims, payments, and offsets in this

situation and reverse-preempt the federal laws on which the Government's Motion to Dismiss relies.[10] Accordingly, the Government's assertion that "federal law" justifies its refusal to pay the Reinsurance amounts owed to Consumers' Choice fails.

2. Even if federal law controlled, it does not permit the offset of non-mutual debts.

Even if federal law controlled the liquidation of insolvent insurers (and it does not), offset is impermissible here because the debts and credits the Government offset against one another are not "mutual." Courts analyzing the right of creditors to offset debts owed to and from an insolvent debtor have emphasized the critical requirement of "mutuality." *Koken v. Legion Ins. Co.*, 865 A.2d 945, 954–55 (Pa. Commw. 2004) (citing William J. Branum, *Setoffs, Recoupments, and Voidable Preferences In the Insolvency Process, in American Bar Association, Law And Practice Of Insurance Company Insolvency Revisited* 907, 933 (F.L. Semaya ed., 1989); *see also O'Connor v. Ins. Co. of N. Am.*, 622 F. Supp. 611, 618 (N.D. Ill. 1985). The Government's motion acknowledges the requirement of mutuality. *See* Mot. to Dismiss at 16 (arguing federal law permits "offset to collect a *mutual* debt owed by an insolvent debtor" and that "[f]ederal courts have consistently recognized that setoff . . . allows entities that owe each other money to apply their *mutual* debts against each other") (citations and internal quotation marks omitted) (emphasis added). As the party seeking offset, the Government has the burden of establishing mutuality. *See, e.g.*, *In re Gregg*, 371 B.R. 817, 819 (Bankr. E.D. Tenn. 2007) ("The creditor has the burden of proof of entitlement to setoff."); *In re Bangert*, 226 B.R. 892, 903 (Bankr. D. Mont. 1998) (same). The Government has failed to meet this burden.

[10] As explained below, the South Carolina Liquidation Act does not permit offset here nor does it permit the Government to elevate the priority of its claims above others. *See* Part III.B, *infra*.

The amounts owed to and from Consumers' Choice lack mutuality because Consumers' Choice's obligation to repay the Start-Up Loan was expressly subordinated to claims payments, operating expenses, and reserve fund requirements, *see* Section I, *supra*, and thus could not be set off against statutory amounts owed to Consumers' Choice. Subordinated debts do not exist in the same right as non-subordinated promissory notes and thus may not be set off against each other. *See Nw. Racquet Swim & Health Clubs, Inc. v. Resolution Trust Corp.*, 927 F.2d 355 (8th Cir. 1991) ("Subordinated debentures in insolvent bank do not, as a matter of both law and equity, meet mutuality of obligation test[.]") (citing *FDIC v. Texarkana Nat'l Bank*, 874 F.2d 264, 268–69 (5th Cir. 1989)); *FDIC v. de Jesus Velez*, 678 F.2d 371 (1st Cir. 1982) (subordinated debentures in insolvent bank are not mutually extinguishable with promissory notes); *see also Sec. Pac. Nat'l Bank v. Resolution Trust Corp.*, 63 F.3d 900 (9th Cir. 1995) (stating subordinated debt generally stays subordinated to the claims of general creditors upon the insolvency of the institution where the subordinated debt served as regulatory capital).

The amounts owed to and from Consumers' Choice further lack mutuality because, as explained above, the Start-Up Loan is better characterized as equity or a capital contribution that cannot be offset against a debt. *See* Part II, *supra*. For both of the foregoing reasons, repayment of the Start-Up Loan lacked mutuality with the reinsurance amounts owed to Consumers' Choice, and thus could not be offset against each other. Federal law fails to justify the offsets.

B. South Carolina law does not authorize offset under the facts presented here.[11]

State law, rather than federal law, controls the liquidation of insolvent insurers. *See generally* Part III.A.1, *supra*. Further, contrary to the Government's assertion, *see* Mot. to Dismiss

[11] This argument is independent of and distinct from Consumers' Choice's state law causes of action. Even if this Court concludes it lacks jurisdiction over the affirmative claims for relief under state law (a conclusion Consumers' Choice disputes, *see* Part V, *infra*), that conclusion does not affect the primacy of state insolvency law and its prohibition on the Government's offset.

at 17–19, the state Liquidation Act does not permit the offset the Government argues excuses its failure to pay the reinsurance amounts owed to Consumers' Choice.

1. The Liquidation Act permits the offsetting of mutual debts, but the debts at issue here are not mutual.

The Liquidation Act states that, subject to certain limitations, *mutual* debts and credits between an insolvent insurer and another person must be set off against each other. *See* S.C. Code Ann. § 38-27-490(a) ("Mutual debts or mutual credits between the insurer and another person in connection with any action or proceeding under this chapter must be set off and the balance only may be allowed or paid, except as provided in subsection (b) of this section and Section 38-27-520."). As explained above, the amounts owed to and from the Government and Consumers' Choice lack mutuality, both because the Start-Up Loan repayments were subordinated to other claims and because the Start-Up Loan is properly characterized as equity rather than a debt. *See* Parts I, II, and III.A.2, *supra*. Because the credits and debts owed to and from Consumers' Choice were not mutual, the Government's offsetting them was not permitted by the Liquidation Act.

2. The Liquidation Act requires payment of policyholders' claims before payment of the Government's claims.

Not only does the Liquidation Act not permit the Government's offset, it affirmatively prevents it. The Liquidation Act expressly sets out the priorities of distributions of claims from the insurer's estate. *See* S.C. Code Ann. § 38-27-610. Under that provision, distinct classes of claims are detailed, and "[e]very claim in each class must be paid in full or adequate funds retained for the payment before the members of the next class receive any payment." *Id.* The Liquidation Act mandates that amounts owed to Consumers' Choice must be paid into the estate and Consumers' Choice's debts will be paid in the priority sequence established by the Liquidation Act. Accordingly, the Reinsurance payments owed by the Government, when received, will be paid to the South Carolina Life and Accident and Health Insurance Guaranty Association ("SCGA").

Under S.C. Code Ann. § 38-27-610, the guaranty association payments, which are policyholder level claims, are recognized as higher priority claims than claims asserted by the Government. These are in Class 2 of the order of distribution of claims. *See id.* On the other hand, the Federal Government's claims against Consumers' Choice are in Class 4 of the order of distribution of claims. *See id.* at § 38-27-610(4). The South Carolina Code, therefore, is explicit that Consumers' Choice's Class 2 claims must be paid in full, along with any Class 3 payments, *prior to* the payment of the Federal Government's Class 4 claims.[12]

Furthermore, a second section of the South Carolina Code also eliminates the availability of offset to the Government. *See* S.C. Code Ann. § 38-27-510. That section provides that reinsurers are not entitled to reduce the amounts recoverable by the Liquidator due to delinquency (*i.e.*, rehabilitation and liquidation) proceedings. As Plaintiffs detailed in their Complaint, the Government was acting as a reinsurer as contemplated by South Carolina law, and chose to reduce the amount of reinsurance payments recoverable by the liquidator as a result of the Consumers' Choice delinquency proceedings. (Compl. at ¶¶ 97, 109(d), and 169–78.) The amounts owed arose as a direct result of Consumers' Choice's financial distress because if the Government had properly paid the amounts rightfully due to Consumers' Choice under the 3Rs programs, it would have been able to meet its obligations and would not have needed to undergo rehabilitation and liquidation. (Am. Compl. at ¶¶ 130–131, Dkt. No. 24.) The Government's use of offset/netting violated this section of the South Carolina Code, which prohibits the Government from making such reductions of payments owed.

[12] The foregoing analysis is not altered by Section 38-27-490, which neither requires nor permits the setoffs the government is trying to make here. As explained in Parts III.A.2 and III.B.1 *supra*, the debts and credits at issue here are ***not*** mutual, and as explained in Part I, *supra*, HHS expressly agreed to subordinate its loan repayment receipts to claims of outside creditors.

C. The Government's violations of the state court Liquidation Order and Executive Order 13765 illustrate the inequitable nature of the Government's conduct.

As alleged in the Complaint, the Government's purported offset violates the state court Liquidation Order and Executive Order 13765. *See, e.g.*, Compl. at Prefatory Statement and ¶¶ 90, 110–11. In response, the Government argues (i) the Liquidation Order did not and could not prohibit or prevent the Government's offsets, and (ii) the Executive Order did not create any enforceable right. *See* Mot. to Dismiss at 20–22. Without conceding these issues or waiving any arguments related thereto, Consumers' Choice merely notes that even *if* the Government's arguments are correct, it makes no difference to the merits of the suit or the disposition of the pending motion. Consumers' Choice has not asserted any claim for violation of the Liquidation Order or of the Executive Order. The Government's violations of the Liquidation Order and Executive Order are not the sole, or even primary, basis of any claim, nor are those violations integral to the merits of any asserted claim. Those violations illustrate the improper, inequitable, and wrongful nature of the Government's conduct, but this Court need not at this stage analyze their substance or determine their effect.

IV. The Complaint alleges contract claims on which relief may be granted.

Plaintiffs assert four contract-based causes of action alleging breach of express and implied-in-fact contracts and of the covenant of good faith and fair dealing, which, individually and collectively, required the Government to make full reinsurance payments and prevented the Government's offsets. As explained more fully below, the Government's arguments for dismissal of these claims fail.[13]

[13] Somewhat remarkably, at the outset of its argument, the Government states, "the Liquidators do not actually dispute that Consumers' Choice received its full reinsurance payment." Mot. to Dismiss at 22. But that is precisely what Plaintiffs have repeatedly and expressly asserted throughout the Complaint. *See, e.g.*, Compl. ¶¶ 56, 86–87, 103–04, 151–52, 166–67, 192–93.

A. The Government breached the QHP Agreements by failing to make the required Reinsurance payments.

The Complaint's third cause of action asserts the Government breached a contract by failing to make reinsurance payments as required by the QHP Agreements. *See* Compl. ¶¶ 115–27. In response, the Government argues the QHP Agreements are "wholly unrelated to" and "have nothing to do with" reinsurance, and implies that the Federal Circuit has agreed with this position. *See* Mot. to Dismiss at 23–24. Both arguments are rebutted below.

As an initial matter, the Government is incorrect when it implies the Federal Circuit has already decided the viability of this claim. To tease out this misapprehension, it is necessary to understand the different claims asserted in *Moda v. United States* and *Land of Lincoln v. United States*, and to understand the courts' rulings in those cases. In *Moda*, the plaintiff alleged a breach of *implied* contract. *See Moda v. United States*, 130 Fed. Cl. 436 (2017), *rev'd by* 892 F.3d 1311 (Fed. Cir. 2018) (cert. petition pending) ("Moda . . . argues in the alternative that the ACA's risk corridors program created an implied-in-fact contract between insurers and the Government."). The Court of Federal Claims agreed, ruling an implied contract could be discerned from the ACA's Risk Corridors statute, its implementing regulations, and HHS' and the insurer's conduct. *Id*. at 462–65. On appeal, a divided panel of the Federal Circuit reversed, declining to imply a contract and holding there was insufficient evidence of governmental intent to contract. *See Moda v. United States*, 892 F.3d 1311, 1330 (Fed. Cir. 2018). The Federal Circuit's holding in *Moda*, however, does not determine the viability of the Plaintiffs' breach of contract claim (Count III) in the instant lawsuit because this claim is premised on the existence of ***express*** contracts—the QHP agreements. Here, there is no question that HHS intended to contract, which is the opposite of the outcome-determinative facts in *Moda*, and which takes this suit outside the scope of the holding in *Moda*.

The Government's reliance on *Land of Lincoln* proves no better. Admittedly, the plaintiff in *Land of Lincoln* asserted claims both for breach of express *and* implied contract. *See Land of Lincoln v. United States*, 129 Fed. Cl. 81, 88 (2016). The Court of Federal Claims dismissed both claims, concluding the express contracts did not establish any contractual commitment pertaining to the Risk Corridors program, and the implied contract was not supported by sufficient evidence of governmental intent to contract. *See id*. at 108–13. The Federal Circuit affirmed in a cursory opinion, the relevant portion of which stated only, "For the reasons stated in our decision in the companion case, *Moda* [], the statutory and contract claims of appellant Land of Lincoln Mutual Health fail." *Land of Lincoln v. United States*, 892 F.3d 1184, 1185 (Fed. Cir. 2018). The opinion in *Moda*, however, had said nothing about any breach of express contract, and the opinion in *Land of Lincoln* contained no reasoning or analysis of its own. Accordingly, the Federal Circuit has not yet squarely opined on the viability of an express breach of contract claim arising from the ACA's 3Rs programs. Accordingly, the only authority on this issue is Judge Lettow's ruling in *Land of Lincoln*—authority that is not binding and which, for the reasons explained below, should not be persuasive to this Court.

In the present litigation, the Government argues the QHP Agreements were too remote or were unrelated to reinsurance payments. *See* Mot. to Dismiss at 23–24. On a Rule 12(b)(6) motion, the Government succeeds only if the Plaintiffs "can prove no set of facts in support of [their] claim which would entitle [them] to relief." *Leider v. United States*, 301 F.3d 1290, 1295 (Fed. Cir. 2002) (citation omitted). In reviewing the motion, "all well-plead factual allegations in the complaint" are assumed true and the court must "draw all reasonable inferences in the plaintiff's favor." *Id.* The Government's argument is insufficient to support dismissal of the claim.

The only element of Consumers' Choice's claim that the Government disputes is whether the QHP Agreements imposed a contractual duty on HHS to comply with its obligation to make reinsurance payments due to Consumers' Choice. *See* Mot. to Dismiss at 23–24. But as Consumers' Choice has alleged, the QHP Agreements are expressly subject to federal statutory and regulatory requirements, including to make reinsurance payments, and HHS contractually committed to undertake all reasonable efforts to support Consumers' Choice's function as a QHP. *See* Compl. at ¶¶ 118 and 121–22 (citing Compl. Ex. B at §§ II.d and V.g; Compl. Ex. C at §§ III.a and V.g.). The fact that these broadly-worded contractual obligations do not specifically mention reinsurance payments (or any other specific way in which the obligations apply) is not an adequate reason to conclude the contract did not impose such an obligation. Dismissal is particularly inappropriate when—as here—the Complaint alleges the contracting parties understood and intended those contract provisions to impose a contractual obligation on the Government to make full and timely reinsurance payments. *See* Compl. ¶¶ 122–23; *see also Am. Satellite Co. v. United States*, 20 Cl. Ct. 710 (1990) ("Construction of a contract is a question of fact which, if disputed, is not susceptible of resolution under a motion to dismiss for failure to state a claim.") (citing *Wolman v. Tose*, 467 F.2d 29, 34 (4th Cir. 1972)).

In sum, Consumers' Choice's third cause of action is not barred by *Moda* or *Land of Lincoln*, it alleges a plausible claim on which relief could be granted, and it is premised on allegations that are not susceptible to dismissal.

B. The Government's offsets breached the Loan Agreement.

The Complaint's fourth cause of action asserts the Government breached a contract by exercising an offset in violation of the Loan Agreement's terms. *See* Compl. ¶¶ 128–36. The Government disputes this claim and argues it should be dismissed. *See* Mot. to Dismiss at 24–25.

For the reasons explained above, the Government's arguments miss the mark, and its motion should be denied. *See* Section I, *supra*.

C. The Government entered and breached an implied-in-fact contract.

The Complaint's fifth cause of action asserts the Government breached an implied-in-fact contract by failing to make full and timely Reinsurance payments to Consumers' Choice in exchange for Consumers' Choice's agreement to become a QHP and participate as a CO-OP in the ACA. *See* Compl. ¶¶ 137–55. In response, the Government argues (i) the United States had no intent to contract; (ii) no HHS official had authority to bind the United States in contract; (iii) the United States did not breach any duty; and (iv) any breach-of-implied-in-fact contract claim premised on the QHP Agreements is duplicative of the Liquidators' claims for breach of those express contracts. *See* Mot. to Dismiss at 25–29. The Government's arguments are addressed in turn below.[14]

Where a plaintiff claims that the Government has breached an implied-in-fact contract, it need only make a "non-frivolous *allegation* of a contract with the government." *Mendez v. United States*, 121 Fed. Cl. 370, 378 (2015) (quoting *Engage Learning, Inc. v. Salazar*, 660 F.3d 1346, 1353 (Fed. Cir. 2011)) (emphasis in original). A plaintiff must therefore plead the elements of a contract with the Government: "(1) mutuality of intent to contract; (2) consideration; (3) an unambiguous offer and acceptance; and (4) actual authority on the part of the government's representative to bind the government." *Fisher v. United States*, 128 Fed. Cl. 780, 785 (2016)

[14] As an initial matter, the Government's arguments rely on the fact that the Federal Circuit in *Moda* held an implied contract claim (involving the ACA's risk corridors program) was not a viable cause of action. To the extent the Government argues *Moda* forecloses Consumers' Choice's implied contract claim, Consumers' Choice notes that opinion is not yet settled law while Moda Health Plan's petition for certiorari is pending before the United States Supreme Court. The United States' response to the petition for certiorari is not due till April 8, 2019.

(quoting *Biltmore Forest Broad. FM, Inc. v. United States*, 555 F.3d 1375, 1380 (Fed. Cir. 2009)). Plaintiffs in the instant lawsuit have pled these allegations. *See* Compl. ¶¶ 137–55. The Government challenges only the first and fourth factor. Each is addressed below.[15]

1. The Government and Consumers' Choice had mutual intent to contract.

Generally, courts "proceed cautiously both in identifying a contract within the language of a regulatory statute and in defining the contours of any contractual obligation." *Brooks v. Dunlop Mfg. Inc.*, 702 F.3d 624, 631 (Fed. Cir. 2012). Therefore, "absent some clear indication that the legislature intends to bind itself contractually, the presumption is that a law is not intended to create private contractual or vested rights but merely declares a policy to be pursued until the legislature shall ordain otherwise." *Nat'l R.R. Passenger Corp. v. Atchison Topeka & Santa Fe Ry. Co.*, 470 U.S. 451, 465–66 (1985).

Statutory provisions that bind the Government in contract "have certain hallmarks." *Moda Health Plan, Inc.*, 130 Fed. Cl. at 463. For example, "the provision must create a program that offers specified incentives in return for the voluntary performance of private parties." *Id.* (citing *Radium Mines, Inc. v. United States*, 153 F. Supp. 403, 405–06 (Ct. Cl. 1957)). "This performance must be in the form of an actual undertaking; simply 'fill[ing] in the blanks of a Government

[15] A challenge to the second factor—consideration—would be fruitless. In exchange for Consumers' Choice's agreement to provide QHPs to consumers on the Exchanges, the Government agreed to make full and timely reinsurance payments under Section 1341. Therefore, consideration existed for the implied-in-fact contract. The third factor is likewise satisfied. There is no ambiguity in offer and acceptance. Section 1341 of the ACA, the implementing regulations, and HHS's and CMS's conduct constituted an unambiguous offer by the Government to make full and timely reinsurance payments to health insurers, including Consumers' Choice, that agreed to participate as a QHP. Offers to enter into unilateral contracts, like the ACA's unilateral offer to insurers to provide QHPs, may only be accepted by performance. Consumers' Choice accepted this offer by providing QHPs on the exchanges and complying with the ACA's requirements despite the uncertain risks imposed by the ACA.

prepared form,' such as an application, does not constitute acceptance by performance." *Id.* (citing *Cutler–Hammer, Inc. v. United States*, 441 F.2d 1179, 1183 (Ct. Cl. 1971)). In addition, "the provision must be promissory; in other words, it must give the agency officials administering the program no discretion to decide whether or not to award incentives to parties who perform." *Id.* (citing *Radium Mines*, 153 F. Supp. at 406). "In short, statutes or regulations show the Government's intent to contract if they have the following implicit structure: if you participate in this program and follow its rules, we promise you will receive a specific incentive." *Id.*

The Government's agreement to make full and timely reinsurance payments to eliminate the risk inherent in the Exchanges was a significant factor material to Consumers' Choice's agreement to enter into the QHP Agreements and to participate as a CO-OP under the ACA. Consumers' Choice, in turn, provided a real benefit to the Government by agreeing to become a QHP and participate in the ACA, despite the uncertain financial risk. Adequate insurer participation was crucial to the Government's achieving the overarching goal of the ACA: to make affordable health insurance available to individuals who previously did not have access to affordable coverage, and to help to ensure every American has access to high-quality, affordable health care by protecting consumers from increases in premiums due to health insurer uncertainty.

The parties' agreement is further confirmed by the parties' conduct, performance, and statements following Consumers' Choice's acceptance of the Government's offer, the execution by the parties of the QHP Agreements expressly incorporating "the laws and common law of the United States of America, including without limitation such regulations as may be promulgated from time to time by the Department of Health and Human Services or any of its constituent agencies." *See* Compl. Ex. A at § V.g; Compl. Ex. B at § V.g. As alleged in Consumers' Choice's Complaint, the ACA's reinsurance program and the parties' conduct meets these criteria.

2. The Secretary of HHS had authority to contract on the Government's behalf.

The Secretary of HHS had actual authority to contract on the Government's behalf. An agent's authority to bind the government is implied when it is "considered to be an integral part of the duties assigned to a government employee." *H. Landau & Co. v. United States*, 886 F.2d 322, 324 (Fed. Cir. 1989) (citation omitted). Here, ACA section 1341 grants the Secretary of HHS authority to establish and operate the reinsurance program. Accordingly, entering into contracts pursuant to the contractual structure of the reinsurance program is an integral part of the Secretary's duties in administering and implementing the ACA, and the Secretary had implied actual authority to contract.

3. The Government's offsets constitute a breach of the implied contract.

The Government argues the offsets did not breach the implied contract because the offsets were (according to the Government) permitted by controlling law. *See* Mot. to Dismiss at 28. The Government is incorrect. As already explained, neither federal law nor state law (which is what controls here) permit the offsets under the circumstances presented here. *See* Part III, *supra*. Accordingly, Consumers' Choice has adequately pled a breach of the implied contract.

4. Consumers' Choice may assert an implied contract claim in addition to, or in the alternative to, its express contract claims.

The Government argues that Consumers' Choice's implied contract claim is "grounded in" an express contract and is thus impermissibly duplicative of the express contract claims. *See* Mot. to Dismiss at 28. The Government's argument, however, is self-defeating. If, as the Government argues, the QHP Agreements had nothing to do with reinsurance and concerned merely software and data communications technicalities, *see id*. at 23–24, then Consumers' Choice's allegation of an implied contract is not duplicative of the express contract and is not "grounded in" it.

Accordingly, Consumers' Choice may raise the claim in addition to or in the alternative to its express contract claims.

D. The Government breached the implied covenant of good faith and fair dealing by diverting Reinsurance amounts due to Consumers' Choice and by failing to set up systems to support QHP functions.

The Complaint's sixth cause of action claims the Government breached the implied covenant of good faith and fair dealing by failing to make the full and timely payments of reinsurance amounts as required by the express or implied contracts. *See* Compl. ¶¶ 156–68. In response, the Government argues Consumers' Choice has "failed to identify any specific contractual promise that was undermined by HHS's" offsets. *See* Mot. to Dismiss at 29. As explained more fully below, however, Consumers' Choice has done exactly that.

A covenant of good faith and fair dealing is implied in every contract, express or implied-in-fact, including those with the Government. *Metcalf Const. Co. v. United States*, 742 F.3d 984, 990 (Fed. Cir. 2014). "Failure to fulfill that duty constitutes a breach of contract." *Id.* The duty of good faith and fair dealing focuses on the "faithfulness to an agreed common purpose and consistency with the justified expectations of the other party." *Id.* at 991. Generally, it "imposes obligations on both contracting parties that include the duty not to interfere with the other party's *performance* and not to act so as to destroy the *reasonable expectations* of the other party regarding the *fruits of the contract.*" *Centex Corp. v. United States*, 395 F.3d 1283, 1304 (Fed. Cir. 2005) (emphasis in original).

Plaintiffs' Complaint alleges the QHP Agreements "created the reasonable expectations for Consumers' Choice that full and timely Reinsurance payments for the 2015 policy year would be paid by the Government to QHPs," and that "[b]y redirecting Reinsurance payments due to Consumers' Choice to pay itself for the Start Up Loan and Risk Adjustment for the 2015 policy

year, the Government destroyed Consumers' Choice's reasonable expectations." Compl. ¶¶ 158 –59. The allegations are sufficient to plead the cause of action. The QHP Agreements require that CMS "undertake all reasonable efforts to implement systems and processes that will support [QHP] functions," but do not define standards for CMS's implementation of the function-supporting systems and processes. *See* Compl. Ex. B at § II.d; Compl. Ex. C at § III.a. Where, as here, an agreement affords CMS the power to make discretionary decisions without defined standards to achieve a mandatory contractual obligation, the duty to act in good faith limits the Government's ability to act capriciously to contravene Consumers' Choice's reasonable contractual expectations.

The express or, alternatively, implied-in-fact contracts entered into between the Government and Consumers' Choice regarding the CY 2014 and 2015 ACA CO-OPs created the reasonable expectations for Consumers' Choice that, in exchange for providing health insurance plans, the Government would make full and timely reinsurance payments. Further, Consumers' Choice and the Government expected that, if Consumers' Choice had profited, it would pay timely reinsurance charges to the Government, and it would have done so in good faith as it had agreed and attested to do. Consumers' Choice satisfied and complied with its obligations and/or conditions which existed under the implied-in-fact contracts.

By failing to make full and timely CY 2014 and CY 2015 risk corridors payments to Consumers' Choice, the Government destroyed Consumers' Choice's reasonable expectations regarding the fruits of the contracts, in breach of an implied covenant of good faith and fair dealing. Consumers' Choice has adequately alleged a reasonable expectation, the Government's destruction of the same, and the Government's interference with its performance. Taking these allegations as true—as, at this stage, the Court must—the claim is not susceptible to dismissal.

V. The Complaint alleges state law claims on which relief can be granted.

The Complaint's seventh, eighth, and ninth cause of action asserts claims for violations of state law. *See* Compl. ¶¶ 169–89. In response, the Government argues this Court lacks jurisdiction over claims arising from state law and that the state law claims fail to assert claims on which relief can be granted. *See* Mot. to Dismiss at 30–35. Each argument is discussed in turn below.

A. This Court has jurisdiction to consider and rule on the state law claims.

The Tucker Act gives this Court jurisdiction over, *inter alia*, suits against the United States arising from federal statutes and regulations and from contracts. *See* 28 U.S.C. § 1491. The claims asserted in the instant proceeding arise from statutes that expressly contemplate the application of state law and the interrelation of state and federal law, *see* 42 U.S.C. §§ 18041(d) and 18042(b)(3); 76 FR 43237-01 (July 20, 2011), and from contracts expressly governed by the law of the state of South Carolina. *See* Ex. A. to Compl., Loan Agreement, § 19.2. This Court may exercise jurisdiction in such cases. *See, e.g.*, *Greene v. United States*, 440 F.3d 1304 (Fed. Cir. 2006) (exercising jurisdiction in a case involving the question of whether a state or federal priority statute governed the payment of an insolvent insurer's claims).

This is particularly true where, as here, a District Court previously dismissed Consumers' Choice's state law claims because the District Court believed this Court had jurisdiction to consider and rule on those claims. *See Farmer v. United States*, No. 3:17-0956-MGL, 2018 WL 1365797, at *10 (D.S.C. March 16, 2018). The District Court's reasoning is instructive:

> [T]he the liquidators contend the Court of Federal Claims is unable to exercise supplemental jurisdiction over its state claims in accordance with 28 U.S.C. § 1367. They are correct in this assertion. *See Proxtronics Dosimetry, LLC v. United States*, 128 Fed. Cl. 656, 669 n.9 (2016) ("28 U.S.C. § 1367(a) applies only to district courts[.]"). Yet, the discussion does not end there.
>
> "Although § 1367 only applies specifically to federal district courts, the concept of pendent jurisdiction . . . is more broadly applicable."

> *Trek Leasing, Inc. v. United States*, 62 Fed. Cl. 673, 678 (2004); *see Liberty Ammunition, Inc. v. United States*, 101 Fed. Cl. 581, 589–92 (2011) (discussing extensively the Court of Federal Claims' ability to use pendent jurisdiction). "Pendent jurisdiction may be assumed . . . at the Court's discretion in the interests of judicial economy, convenience, and fairness." *Kennedy v. United States*, 19 Cl. Ct. 69, 76 (1989). The Court of Federal Claims "has traditionally interpreted many different state laws in the course of making its decisions in a variety of areas, including: environmental and public nuisance laws; intestacy laws; property law; and contract law[.]" *Trek*, 62 Fed. Cl. at 678 (citations omitted).
>
> ***Consequently, the Court of Federal Claims is able to adjudicate any state claims by the liquidators' via pendant jurisdiction***. ***To the extent the Court of Federal Claims needs to apply South Carolina's priority scheme, it is able to do that, too***. *See Greene v. United States*, 440 F.3d 1304 (Fed. Cir. 2006) (reviewing the Court of Federal Claims' application of a state priority statute).

Id. (emphasis added). Having persuaded the District Court that Consumers' Choice's state law claims could be adjudicated in the Court of Federal Claims, the Government cannot now argue this Court lacks jurisdiction over them. To allow otherwise would mean the Government's violations of state insolvency law could *never* be challenged in *any* court—a result that would be as unfair as it is inequitable.

B. The state law causes of action assert plausible claims for relief.

The Complaint's seventh, eighth, and ninth cause of action asserts a claim for breach of state insurance insolvency laws that prohibit reinsurers from reducing reinsurance payments in light of the insurer's insolvency, mandate a priority of payments of claims against the insolvent insurer's estate, and prohibit insider preferences. *See* Compl. ¶¶ 169–89. Each of the Government's arguments in, *see* Mot. to Dismiss at 31–34, is addressed in turn below.

1. State statutes need not expressly use the word "offset" to prohibit the Government's conduct.

The Government argues the Liquidation Act statutes relied on by Consumers' Choice cannot prohibit the Government's offsets because those statutes do not mention the word "offset."

See Mot. to Dismiss at 31. The Government's simplistic argument misses the point. These statutes need not, and indeed cannot, expressly mention every way in which a creditor of an insolvent insurer might violate the statutes' mandates. Rather, they establish the rules governing the liquidation of an insolvent insurer—*e.g.*, the priority and sequence of payments in and payments out, the necessity to make full reinsurance payments undiminished by the insurers' insolvency, and the prohibition on insider preferences—and they prohibit *any* conduct (which would include offsets of the type performed by the Government) that would violate their command.

The Government's argument that the Liquidation Act's setoff statute permits the offsets at issue here fares no better. *See id*. As already explained, the Liquidation does not permit the offset of non-mutual debts like those at issue here. *See* Part III.B.1, *supra*. In sum, Plaintiffs have adequately pled the Government violated these state statutes. *See* Compl. ¶¶ 169–89; *see also* Part III.B.2, *supra*. Dismissal is inappropriate, and the Government's motion should be denied.

2. The ACA and its implementing regulations do not supersede or preempt state law governing insolvent insurers.

The Government next argues the ACA preempts the Liquidation Act statutes relied on by Consumers' Choice. *See* Mot. to Dismiss at 32–33. The Government supports this argument with numerous citations to cases standing for the general proposition that federal law governs disputes arising under nationwide programs. *See id.* This general rule, however, gives way here to the numerous express statements in the ACA itself, the Loan Agreement executed by the parties, and the Supreme Court's ruling in *Fabe* that state law controls disputes involving the liquidation of insolvent insurers, even when those disputes touch on national programs like the ACA. *See generally* Part III.A, *supra*; see also 42 U.S.C. §§ 18041(d) and 18042(b)(3); *United States Department of Treasury v. Fabe*, 508 U.S. 491 (1993); Proposed Rules, 45 C.F.R. Part 156, 76 FR

43237-01 (July 20, 2011); Final Rules, Responses and Comments, 45 C.F.R. 156, E.6 and F (Dec. 13, 2011).

3. The Complaint alleges a viable claim that the Government, acting as a reinsurer, violated state law by reducing Consumers' Choice's reinsurance payments due to its insolvency.

Notwithstanding the fact that HHS created and operated a reinsurance program bearing all the traditional hallmarks of reinsurance as that concept is used and understood in the industry, and in which HHS/CMS functioned as a reinsurer in the same way that concept is used and understood in the law and in the industry, the Government argues HHS/CMS was not *really* a reinsurer and thus is not bound by the statutory obligations imposed on other insurers. *See* Mot. to Dismiss at 34. The sole authority the Government cites in support of this argument is a statutory definition of "reinsurer" found in a different chapter of the South Carolina Code in a definition section that expressly applies only "in *this* chapter," *i.e.*, *not* to the terms used in the Liquidation Act. *See* S.C. Code Ann. § 38-46-20. The Government's argument that HHS/CMS were not acting as reinsurers as contemplated by the Liquidation Act is incredible, unsupported, and would require the Court to make a factual determination that is not appropriate in a ruling on a motion to dismiss.

4. The Government's offset unlawfully upends the priority of distribution mandated by state law.

The Government next argues its alleged ability to offset reinsurance payments owed to Consumers' Choice against debts allegedly owed by Consumers' Choice is unaffected by the Liquidation Act's priority of the payments in and out of the insurer's estate. *See* Mot. to Dismiss at 34. The flaws of this argument have already been explained. *See* Parts III.A and III.B, *supra*.

5. The Complaint alleges a viable claim that the Government, acting as an insider, unlawfully elevated its claim by way of a voidable preference.

The Government argues its offset was not a voidable insider preference because (according to the Government) an offset is not a preference and the offset of mutual debts is permissible. The

Government's argument suffers from at least two flaws. First, it is premised on the erroneous belief that the offsets it performed were of mutual debts. This is incorrect. *See* Parts III.A.2 and III.B.2, *supra*. Second, the Government's argument assumes facts that should not be resolved in a motion to dismiss but, rather, should be assumed to be true as pled in the Complaint, *e.g.*, that the facts will show the Government was an insider acting in a preferential way. Accordingly, the Government's argument is not one upon which dismissal may be granted.

VI. The Complaint alleges a Takings claim on which relief can be granted.

Consumers' Choice's tenth cause of action asserts a Taking in violation of the Fifth Amendment by failing to make full and timely reinsurance payments. *See* Compl. ¶¶ 190–95. In response, the Government argues a statutory obligation to pay money cannot constitute a "property interest" within the scope of the Takings clause. *See* Mot. to Dismiss at 35–36. In support of its argument, the Government relies on the Federal Circuit's holding in *Land of Lincoln*. *See id.* (citing *Land of Lincoln*, 892 F.3d at 1186). Consumers' Choice respectfully submits the holding in *Land of Lincoln* is incorrect and, in any event, is not settled law as the insurer's petition for certiorari is still pending at the United States Supreme Court.[16]

In the absence of settled, controlling law in this precise context, Consumers' Choice has adequately pled a claim for a taking. A claimant asserting a Takings claim must allege the government, through specific action, took a private property interest for public use without just compensation. *See Hodel v. Va. Surface Mining & Reclamation Ass'n*, 452 U.S. 264, 294 (1981). Review of a takings claim "calls for a two-step analysis." *Karuk Tribe v. Ammon*, 209 F.3d 1366, 1374 (Fed. Cir. 2000). "First, a court determines whether the plaintiff possesses a valid interest in the property affected by the governmental action, i.e., whether the plaintiff possessed a 'stick in

[16] The United States' response to the petition is due April 8, 2019.

the bundle of property rights.'" *Id.* (citing *M&J Coal Co. v. United States*, 47 F.3d 1148, 1154 (Fed. Cir. 1995)). "The second step of the analysis, an intensely factual inquiry, includes consideration of the character of the governmental action, the economic impact of the action on the claimant, and the reasonable expectations of the claimant." *Id.*

Here, Plaintiffs have alleged compensable vested rights in the reinsurance payments for 2015. *See* Compl. ¶¶ 190–95. First, Consumers' Choice had a "vested property interests in its contractual, statutory, and regulatory rights to receive statutorily-mandated Reinsurance payments for the 2015 policy year." *Id.* at ¶ 192. As a QHP, it possessed the "stick in the bundle of property rights." *Karuk Tribe*, 209 F.3d at 1374. Second, step two of the two-step inquiry simply cannot be resolved on a motion to dismiss given its "intense[] factual inquiry." *Id.* Having properly pled the claim, the Government's motion should be denied and the claim should proceed.

CONCLUSION

Plaintiffs have stated claims for relief that are plausible on their face. Accordingly, for the reasons stated above, the Court should deny the Government's motion to dismiss.

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April 15, 2019

Farmer et al. v. United States
Court of Federal Claims case no. 18-1484C

Exhibit A

to the Plaintiffs' Response in Opposition to the
United States' Motion to Dismiss the Complaint

Liquidation Order, Richland County Court of Common Pleas

FORM 4

STATE OF SOUTH CAROLINA
COUNTY OF RICHLAND
IN THE COURT OF COMMON PLEAS

JUDGMENT IN A CIVIL CASE

CASE NUMBER: 2016CP4000034

Raymond G Farmer
SC Department of Insurance
PLAINTIFF(S)

Consumers Choice Health Insurance Company
DEFENDANT(S)

Submitted by: _____

Attorney for : ☐ Plaintiff ☐ Defendant or ☐ Self-Represented Litigant

DISPOSITION TYPE (CHECK ONE)

☐ **JURY VERDICT.** This action came before the court for a trial by jury. The issues have been tried and a verdict rendered.

☐ **DECISION BY THE COURT.** This action came to trial or hearing before the court. The issues have been tried or heard and a decision rendered.

☐ **ACTION DISMISSED** (*CHECK REASON*): ☐ Rule 12(b), SCRCP; ☐ Rule 41(a), SCRCP (Vol. Nonsuit); ☐ Rule 43(k), SCRCP (Settled); ☐ Other _____

☐ **ACTION STRICKEN** (*CHECK REASON*): ☐ Rule 40(j), SCRCP; ☐ Bankruptcy; ☐ Binding arbitration, subject to right to restore to confirm, vacate or modify arbitration award; ☐ Other _____

☐ **DISPOSITION OF APPEAL TO THE CIRCUIT COURT** (*CHECK APPLICABLE BOX*): ☐ Affirmed; ☐ Reversed; ☐ Remanded; ☐ Other _____

NOTE: ATTORNEYS ARE RESPONSIBLE FOR NOTIFYING LOWER COURT, TRIBUNAL, OR ADMINISTRATIVE AGENCY OF THE CIRCUIT COURT RULING IN THIS APPEAL.

IT IS ORDERED AND ADJUDGED: ☐ See attached order (formal order to follow) ☐ Statement of Judgment by the Court:

2018 MAR 28 AM 11:54 FILED

ORDER INFORMATION

This order ☐ ends ☐ does not end the case.
Additional Information for the Clerk : _____

INFORMATION FOR THE JUDGMENT INDEX

Complete this section below when the judgment affects title to real or personal property or if any amount should be enrolled. If there is no judgment information, indicate "N/A" in one of the boxes below.

Judgment in Favor of (List name(s) below)	Judgment Against (List name(s) below)	Judgment Amount To be Enrolled
		$
		$
		$

If applicable, describe the property, including tax map information and address, referenced in the order:

The judgment information above has been provided by the submitting party. Disputes concerning the amounts contained in this form may be addressed by way of motion pursuant to the SC Rules of Civil Procedure. Amounts to be computed such as interest or additional taxable costs not available at the time the form and final order are submitted to the judge may be provided to the clerk. **Note: Title abstractors and researchers should refer to the official court order for judgment details.**

Circuit Court Judge _____ Judge Code 2118 Date _____

For Clerk of Court Office Use Only

This judgment was entered on the ___ day of _____, 20___ and a copy mailed first class or placed in the appropriate attorney's box on this 29 day of March, 20 18 to attorneys of record or to parties (when appearing pro se) as follows:

Geoffrey Ross Bonham

ATTORNEY(S) FOR THE PLAINTIFF(S)

ATTORNEY(S) FOR THE DEFENDANT(S)

Court Reporter _____

Clerk of Court Jeanette W. McBride

STATE OF SOUTH CAROLINA RICHLAND COUNTY	IN THE COURT OF COMMON PLEAS FIFTH JUDICIAL CIRCUIT
Raymond G. Farmer, as Director of the South Carolina Department of Insurance. Petitioner, vs. Consumers' Choice Health Insurance Company, Respondent.	Civil Action No. 2016-CP-40-00034 **ORDER COMMENCING LIQUIDATION PROCEEDINGS & GRANTING AN INJUNCTION & AUTOMATIC STAY OF PROCEEDINGS**

This matter comes before me pursuant to the South Carolina Insurers Supervision, Rehabilitation and Liquidation Act, S.C. Code Ann. §§ 38-27-10 *et seq.* Petitioner, Raymond G. Farmer, as Director of the South Carolina Department of Insurance, by and through counsel, has petitioned the Court for an Order appointing him as Liquidator of Respondent, Consumers' Choice Health Insurance Company, in Rehabilitation. Petitioner is the Receiver for Respondent by previous order of this Court entered January 8, 2016. The instant Petition was filed and served on Respondent on February 17, 2016. Respondent has reasonable notice of the Petition pursuant to Section 38-27-60 of the Code of Laws of South Carolina 1976, as amended; and, Respondent's Board of Directors has indicated through counsel that it has no objection to the Petition being granted and waives hearing on this matter.

The Court, having reviewed the filings of record and otherwise being fully informed in the premises, finds:

1. This Court is the proper venue for this proceeding pursuant to S.C. Code Ann. §§

38-27-60(f), -350(a) & -360 (2015).

2. Petitioner is the duly appointed Director of the State of South Carolina Department of Insurance with such powers, duties and responsibilities as are prescribed under the insurance laws of this State to the Director or his designee for receivership matters, and is specifically authorized to file a petition for an order authorizing him to liquidate an insurer domiciled in this State pursuant to S.C. Code Ann. §§ 38-27-350(a), -360 & 38-90-180(A) (2015).

3. The Department has regulatory jurisdiction over the Respondent pursuant to, *inter alia*, Chapters 3, 25 and 71 of Title 38 of the South Carolina Code of Laws 1976, as amended.

4. Respondent is a South Carolina Consumer Operated and Oriented Plan (CO-OP) that was placed into rehabilitation by Order of this Court on or about January 8, 2016. Said Order also provides that upon petition by the Receiver stating that further efforts to rehabilitate Respondent would substantially increase the risk of loss to creditors, policyholders or the public, or would be futile, this Court will consider entry of an Order of Liquidation of Respondent in accordance with S.C. Code Ann. § 38-27-350(a) (2015) and such petition shall have the same effect as a petition filed under S.C. Code Ann. § 38-27-360 (2015).

5. S.C. Code Ann. § 38-27-360 sets forth the following grounds upon which an insurer may be placed into liquidation:

a. Any ground for an order of rehabilitation as specified in S.C. Code Ann. § 38-27-310 (2015), whether or not there has been a prior order directing the rehabilitation of the insurer;

b. The insurer is insolvent; or

c. The insurer is in such a condition that the further transaction of business would be hazardous, financially or otherwise, to its policyholders, its creditors, or the public.

6. Grounds for rehabilitation proceedings listed in Section § 38-27-310, include, but are not limited to, when the insurer is in a condition in which the further transaction of business would be hazardous, financially, to its policyholders, creditors, or the public; Petitioner has attempted to rehabilitate Respondent, and his duly-appointed deputy has submitted an affidavit describing those efforts and confirming that further attempts to rehabilitate an insurer would substantially increase the risk of loss to creditors, policyholders, or the public or would be futile.

7. The Special Deputy Receiver has concluded that Respondent is irreversibly insolvent, by more than $39 million as of December 31, 2015; the South Carolina Life and Accident and Health Guaranty Association has been charged with performing its statutory obligation to fund all covered claims in accordance with Chapter 29 of Title 38 of the Code of Laws of South Carolina 1976, as amended; and, the implementation now of a formal proof of claim process provided under S.C. Code Ann. § 38-27-550 (2015) will best serve and protect the interests of creditors, policyholders, and the public.

8. Respondent is in a condition in which the further transaction of business would be hazardous, financially or otherwise, to its policyholders, creditors, or the public, which constitutes grounds for liquidation under Section 38-27-360; and Respondent is insolvent as defined by S. C. Code Ann. § 38-27-50(10)(b) (2015), in that it is unable to pay its obligations when they are due and its admitted assets do not exceed its liabilities plus the capital and surplus required by law.

9. In accordance with S.C. Code Ann. § 38-27-350(a) (2015), Petitioner has established to the satisfaction of the Court that further attempts to rehabilitate Respondent would substantially increase the risk of loss and/or be futile.

10. The Court has jurisdiction over this matter.

11. It is in the best interest of Respondent, its policyholders, its creditors and the public that the relief requested be granted.

IT IS THEREFORE ORDERED THAT:

1. PURSUANT TO S.C. Code Ann. § 38-27-370 (2015), Petitioner and his successors in office are appointed Liquidator of Respondent.

2. PURSUANT TO S.C. Code Ann. § 38-27-370(B) (2015), the rights and liabilities of the insurer and its creditors, policyholders, shareholders, members, and other persons interested in its estate become fixed as of the date of entry of the order of liquidation, except as provided in S.C. Code Ann. §§ 38-27-380 and 38-27-560 (2015); and, any claim excepted under this provision and Section 38-27-370(B) shall be governed by Sections 38-27-380 and 38-27-560, as applicable.

2. PURSUANT TO S.C. Code Ann. § 38-27-400(a) (2015), Petitioner and his successors shall have all the powers and responsibilities set forth under that section to assist him or his designee as Liquidator, including but not limited to:

a. To appoint a special deputy to act for him and to determine the special deputy's reasonable compensation, who shall have all powers of the Liquidator granted by this section and who serves at the pleasure of the Liquidator.

b. To employ employees and agents, legal counsel, actuaries, accountants, appraisers, consultants, and other personnel he considers necessary to assist in the liquidation.

c. To fix the reasonable compensation of employees and agents, legal counsel, actuaries, accountants, appraisers, and consultants with the Court's approval.

d. To pay reasonable compensation to persons appointed and to defray from the funds or assets of the insurer all expenses of taking possession of, conserving, conducting, liquidating, disposing of, or otherwise dealing with the business and property of Respondent. In the event that Respondent's property does not contain sufficient cash or liquid assets to defray the costs incurred, the Director may advance the costs so incurred out of any appropriation for the maintenance of the Department of Insurance. Any amounts so advanced for expenses of administration must be repaid to the Director for the use of the Department out of the first available monies of the insurer.

e. To hold hearings, to subpoena witnesses to compel their attendance, to administer oaths, to examine any person under oath, and to compel any person to subscribe to his testimony after it has been correctly reduced to writing and, in connection therewith, to require the production of any books, papers, records, or other documents which he considers relevant to the inquiry.

f. To collect all debts and monies due and claims belonging to Respondent, wherever located, and, for this purpose:

(i) To institute timely action in other jurisdictions in order to forestall garnishment and attachment proceedings against the debts.

(ii) To do other acts necessary or expedient to collect, conserve, or protect its assets or property, including the power to sell, compound, compromise, or assign debts for purposes of collection upon terms and conditions he considers best.

(iii) To pursue any creditor's remedies available to enforce his claims.

g. To conduct public and private sales of the property of Respondent.

h. To use assets of the estate of Respondent to transfer policy obligations to a solvent assuming insurer, if the transfer can be arranged without prejudice to applicable priorities under S.C. Code Ann. § 38-27-610 (2015).

i. To acquire, hypothecate, encumber, lease, improve, sell, transfer, abandon, or otherwise dispose of or deal with any property of Respondent at its market value or upon terms and conditions that are fair and reasonable. He also has power to execute, acknowledge, and deliver any and all deeds, assignments, releases, and other instruments necessary or proper to effectuate any sale of property or other transaction in connection with the liquidation.

j. To borrow money on the security of Respondent's assets or without security and to execute and deliver all documents necessary to that transaction for the purpose of facilitating the liquidation.

k. To enter into contracts necessary to carry out the order to liquidate, and to affirm or disavow any contracts to which the insurer is a party.

l. To continue to prosecute and to institute in the name of Respondent or in his own name any and all suits and other legal proceedings, in this State or elsewhere, and to abandon the prosecution of claims he considers unprofitable to pursue further. If Respondent is dissolved under S.C. Code Ann. § 38-27-390 (2015), he has the power to apply to any court in this State or elsewhere for leave to substitute himself for Respondent as plaintiff.

m. To prosecute any action which may exist in behalf of the creditors.

members, policyholders, or shareholders of Respondent against any officer of Respondent or any other person.

n. To remove any or all records and property of Respondent to the offices of the Department or to any other place convenient for the purposes of efficient and orderly execution of the liquidation, *provided* that guaranty associations and foreign guaranty associations shall have such reasonable access to the records of Respondent as is necessary for them to carry out their statutory obligations.

o. To deposit in one or more banks in this State sums required for meeting current administration expenses and dividend distributions.

p. To invest all sums not currently needed, unless the Court orders otherwise.

q. To file any necessary documents for recording in the office of any recorder of deeds or record office in this State or elsewhere where property of Respondent is located.

r. To assert all defenses available to Respondent as against third persons, including statutes of limitation, statutes of fraud, and the defense of usury. A waiver of any defense by Respondent after a petition in liquidation has been filed does not bind the Liquidator. Whenever a guaranty association or foreign guaranty association has an obligation to defend any suit, the Liquidator shall give precedence to that obligation and may defend only in the absence of a defense by the guaranty associations.

s. To exercise and enforce all the rights, remedies, and powers of any creditor, shareholder, policyholder, or member, including any power to avoid any transfer or lien that may be given by the general law and that is not included with S.C. Code Ann. §§ 38-27-450

through 38-27-470 (2015).

t. To intervene in any proceeding wherever instituted that might lead to the appointment of a receiver or trustee and to act as the receiver or trustee whenever the appointment is offered.

u. To enter into agreements with any receiver or commissioner of any other state relating to the rehabilitation, liquidation, conservation, or dissolution of an insurer doing business in both states.

v. To exercise all powers now held or hereafter conferred upon receivers by the laws of this State not inconsistent with applicable law.

w. To audit the books and records of agents of Respondent insofar as those records relate to the business activities of the insurer.

x. Notwithstanding the powers of the Liquidator as enumerated above and granted pursuant to Section 38-27-400, the Liquidator is not obligated to defend claims or to continue to defend claims after the entry of a liquidation order.

3. PURSUANT TO S.C. Code Ann. § 38-27-400(b) (2015), the enumeration in this Order of the powers and authority of the Liquidator may not be construed as a limitation upon him; nor shall it exclude in any manner his right to do other acts not herein specifically enumerated, or otherwise provided for, that may be necessary or appropriate for the accomplishment of or in aid of the purpose of liquidation.

4. PURSUANT TO S.C. Code Ann. §§ 38-27-410, -540 & -550 (2015), the Liquidator shall provide Notice of this Order, prescribe the form of a Proof of Claim to be used by all

claimants, which shall set forth the date for submission of claims, or Bar Date, after which no claim will be allowed except as provided in Section 38-27-540, except that the Liquidator shall not be required to provide further notice or a Proof of Claim to health care providers; and, said Bar Date is hereby set as December 31, 2016.

5. PURSUANT TO S.C. Code Ann. §§ 38-27-70 & -430 (2015) and the Rehabilitation Order, Notice is hereby given that the permanent automatic stay and injunction applicable to all persons and proceedings, other than the Receiver, shall remain in full force and effect and survive the entry of this Order.

6. All other provisions of the Rehabilitation Order not inconsistent with this Order or the laws governing insurance company liquidation proceedings shall remain in full force and effect to the extent necessary or appropriate for the accomplishment of the liquidation or to aid the Liquidator in effecting the purpose of the liquidation.

7. Continuation and cancellation of coverage shall be governed by S.C. Code Ann. § 38-27-380(b) (2015).

8. Upon filing by the Liquidator with the office of the Secretary of State a certified true copy of the Liquidation Order, Respondent is dissolved in accordance with S.C. Code Ann. § 38-27-390 (2015).

9. Respondent is hereby officially declared insolvent as defined by S.C. Code Ann. § 38-27-50(10) (2015).

10. Petitioner's designation of Michael J. FitzGibbons of FitzGibbons and Company, Inc., 9821 N. 95th St., Suite 105, Scottsdale, Arizona 85258, as a consultant to the Liquidator and as Special Deputy Liquidator, in this matter, with such reasonable compensation as determined by

the Liquidator pursuant to S.C. Code Ann. § 38-27-400(a)(1) (2015) is hereby expressly approved, and said Special Deputy Liquidator shall have all powers of the Liquidator granted by S.C. Code 38-27-400 (2015) and this Order and shall serve at the pleasure of the Liquidator.

11. This Court retains jurisdiction of this cause for the purpose of granting such other and further relief as from time to time may be necessary and appropriate.

AND IT IS SO ORDERED.

Alison R. Lee
Chief Administrative Judge
Fifth Judicial Circuit

This 24th day of March, 2016
Columbia, South Carolina

Farmer et al. v. United States
Court of Federal Claims case no. 18-1484C

Exhibit B

to the Plaintiffs' Response in Opposition to the
United States' Motion to Dismiss the Complaint

Letter from CMS to CO-OP Project Officers, July 9, 2015

DEPARTMENT OF HEALTH & HUMAN SERVICES
Centers for Medicare & Medicaid Services
Center for Consumer Information and Insurance Oversight
200 Independence Avenue SW
Washington, DC 20201

CENTERS FOR MEDICARE & MEDICAID SERVICES
CENTER FOR CONSUMER INFORMATION & INSURANCE OVERSIGHT

TO: CO-OP Project Officers
FROM: Kelly O'Brien, CO-OP Division Director
RE: Amending CO-OP Loans Agreement to Apply Surplus Notes to Start-up Loans
Date: July 9, 2015

Dear CO-OP Project Officers:

This notice is to inform you that the Centers for Medicare & Medicaid Services (CMS) will now allow CO-OPs to request that surplus notes be applied to Consumer Operated and Oriented Plan (CO-OP) Program start-up loans. Applying surplus notes to the start-up loans will enable CO-OP borrowers to record those loans as assets in financial filings with regulators. The start-up loans will be subject to commensurate terms of subordination, interest accrual, and repayment.

To pursue this change, a CO-OP loan recipient must provide CMS a written request that includes the following:

1. A justification or explanation of the specific benefit or benefits that the CO-OP expects to receive from the change;
2. Actuarially certified life of loan financial projections that reflect the implementation of the change, and an explanation of any key assumptions in those projections. Projections should include, but not be limited to:
    a. debt service coverage ratios;
    b. actual and/or projected payments made or received through the Risk Adjustment, Reinsurance, and Risk Corridors programs; and
    c. risk based capital levels with respect to state requirements;
3. A description of the adverse impact to the CO-OP if the change is not implemented. For example, if a CO-OP anticipates they will fall below RBC level requirements absent this action; and
4. Actuarially certified life of loan financial projections that do not reflect the implementation of the change. Projections should include, but not be limited to:
    a. debt service coverage ratios;
    b. actual and/or projected payments made or received through the Risk Adjustment, Reinsurance, and Risk Corridors programs; and

c. risk based capital levels with respect to state requirements.

Please note the following:

- It is necessary to amend the loan agreement to subject your start-up loan to a surplus note. **Attachment A** is the CMS-approved template to amend your loan agreement for these purposes. Proposed revisions to the template that are material will likely require further administrative review and approval, so we urge acceptance of the amendment as proposed here unless a material revision is absolutely necessary.

- Repayment due dates, interest rates, and disbursement processes are unaffected by this amendment.

- All active CO-OP loan recipients may request to enter into this amendment. In evaluating whether to approve these requests, CMS will consider the likelihood that the request will result in the overall benefits outlined by the applicant.

- Please communicate any questions or concerns related to the template of the amendment at your earliest convenience. Once the template is agreed to, CMS will provide a proposed amendment that includes amounts and parties.

- The proposed amendment that reflects amounts and parties must be approved by your state regulator before it can be executed. CMS will arrange calls with you and your regulator to discuss the proposed amendment, and make any necessary revisions.

- Once approved by your regulator, borrowers will execute the amendment and provide an image of the executed amendment to CMS.

- CMS will execute the amendment last, and provide an image of the executed amendment to each borrower.

- A CO-OP loan recipient who chooses not to apply at this time or whose application is denied may apply at their discretion in the future, and requests will be reviewed on a rolling basis.

Please communicate questions, concerns, and your intent to amend your loan agreement consistent with this notice by emailing your account manager, Kevin Kendrick at *kevin.kendrick@cms.hhs.gov*, and Jamaca Mitchell at *Jamaca.mitchell@cms.hhs.gov.*

Attachment (1)

cc: State Insurance Commissioners

ATTACHMENT A

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[ ] AMENDMENT TO LOAN AGREEMENT

I. Purpose

The purpose of this [____] Amendment ("Amendment") is to amend the Loan Agreement dated [**, 2012**] ("Agreement"), between [**CO-OP\Borrower Full Legal Name**] ("Borrower"), and the Centers for Medicare & Medicaid Services ("Lender") (Lender and Borrower together are "the Parties"), through a written amendment consistent with Section 19.4 thereof. This Amendment shall serve the purpose of, among other things, replacing Appendix 2 of the Agreement with that Appendix 2 attached as Attachment 1 hereto, for the purpose of enabling the outstanding balance of the Start-up Loan to be treated as the proceeds of a surplus note pursuant to National Association of Insurance Commissioners Statement of Statutory Accounting Principles No. 41 (SSAP 41). The Parties intend that this Amendment is necessary to advance the Parties' mutual interest, and that the [**STATE**] [**Insurance Commissioner or equivalent]** acknowledges the promissory note contained in Appendix 2 of the Agreement as a surplus note within the meaning of SSAP 41, and thus accept the proceeds of the Start-Up Loan (designated as "Series A" on the facing page of the Agreement) provided pursuant to the Agreement as an asset for purposes of determining and acknowledging regulatory capital and surplus.

II. Amendment

Accordingly, the Parties hereby agree to amend the Agreement as follows:

1. By replacing the version of Appendix 2 to the Agreement that existed prior to the execution of this Amendment with that new Appendix 2 attached as Attachment 1 to this Amendment.

2. In the Definition section, under the defined terms "Interest" or "Interest Amount," inserting a period after the phrase "Accrual Period" and deleting the remainder of the text.

3. Deleting the text of the section entitled "4.3 Interest" in its entirety and replacing it with the following text:

> The Interest rate for the Start-Up Loan and any individual Disbursement thereof shall be fixed for the life of the Loan at the amount in Appendix 6, which represents the Treasury rate on five year securities in effect on the initial Date of Award minus one percentage point ("Interest Rate"); provided, however, that in the event this Agreement is earlier terminated for cause under Section 16.3 below, the Interest Rate for the Start-Up Loan shall be fixed at the rate in Appendix 6, which is equal to the Treasury rate on five year securities based on the Date of Award. Interest on the Start-Up Loan and each individual Disbursement thereof shall, subject to all terms and limitations in the Start-up Loan Promissory attached hereto and incorporated herein by reference as Appendix 2, accrue on a monthly basis using a 360-day year and 30-day month for actual days elapsed. Interest shall be payable according to the Repayment Schedule attached to this Agreement and incorporated herein by reference as Schedule A of Appendix 2.

4. Deleting the text of the second paragraph of the section entitled "4.4 Repayment of Start-Up Loan" in its entirety and replacing it with the following text:

> Unless Lender terminates this Agreement for cause under Section 16.3 below, Borrower shall, subject to all terms and limitations in the Start-up Loan Promissory attached hereto and incorporated herein by reference as Appendix 2.l be obligated to repay 100 percent of the Start-Up Loan amount disbursed, plus any Interest due to Lender in accordance with the Repayment Schedule for the Start-Up Loan, subject to its ability to meet State Reserve Requirements and other solvency regulations, or requisite surplus note arrangements.

5. Deleting in its entirety the last sentence of the section entitled "5.5 Interest".

6. Deleting the text of paragraph (a) of the section entitled "15.1 Events of Default" in its entirety and replacing it with the following text:

> Borrower, for reasons other than a State's Solvency Payment Restriction, fails to pay any installment of Principal or Interest on a Loan or other Obligation for more than 60 days after the date the same is due, subject to any applicable surplus note limitations in the Start-up Loan Promissory Note or the Solvency Loan Promissory Note attached hereto

and incorporated herein by reference as Appendices 2 and 4, respectively, and such delinquent payment is not subsequently recapitalized in accordance with the terms hereof.

7. Replacing all occurrences of the phrase "capitalized interest," in section 5.6 or otherwise throughout the Agreement, with the phrase "interest due."
8. Deleting in its entirety the second sentence of the text below the table in Schedule A to Appendix 2.

III. Execution and Effective Date

This Amendment may be executed by the Parties in any order and is effective upon execution by the last of the two Parties to so execute. This Amendment may be executed in counterparts.

IV. No Other Change

Except as expressly modified herein, all other terms and conditions of the Agreement shall remain in full force and effect, and are hereby ratified, endorsed and reaffirmed by the Parties hereto, as witnessed by their respective signatures below. In conjunction therewith, each Party hereby expressly agrees to abide by and be legally bound by all covenants, terms and conditions of the Agreement, as the same be modified hereby. In the event of a conflict between any provision of the Agreement as originally drafted and the provisions of this Amendment, the provisions of this Amendment shall control.

IN WITNESS WHEREOF, Lender and Borrower have executed this Amendment as of the date indicated by each signature.

For Lender:

Per: _____
Name: Kevin Counihan
Title: Director, Center for Consumer Information and Insurance Oversight
Marketplace CEO

Date: _____

For Borrower:

Per: _____
Name:
Title:

Date: _____

ATTACHMENT 1

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Appendix 2

START-UP LOAN PROMISSORY NOTE

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U.S. Department of Health and Human Services,
Centers for Medicare & Medicaid Services

CO-OP Loan Borrower's Start-Up Loan, Series A, Dated _____

PROMISSORY NOTE

Loan #: Start Up Loan Series A
This day of_____, 201_
By:
Title:
[Address]
[CO-OP] **("Borrower")**

The Start-up Loan provided pursuant to the Loan Agreement of which this Promissory Note is a part, and is incorporated into as Appendix 2, is a Surplus Note. Accordingly, Borrower promises, agrees, and covenants to pay to the order of Lender, the United States Department of Health and Human Services, Centers for Medicare & Medicaid Services (and its successors) the amounts specified in Schedule A below (this amount is called "Principal"), plus interest. Notwithstanding any conflicting provisions contained in the Loan Agreement, other than Section 3.4 of the Loan Agreement which is incorporated herein by reference. Payment shall be on the terms and subject to the conditions set forth in this Surplus Note. Interest shall not compound and shall be computed annually for the twelve (12) months ending on the anniversary of each disbursement on the basis of a year of twelve thirty-day months.

Borrower agrees to pay Principal and interest in the installments listed in Schedule A below, as may be amended from time to time.

PROVIDED, HOWEVER, that payment of Principal and interest shall be subject to the following conditions:

1. This surplus note shall not be a liability or claim against Borrower or any of its assets, except as provided in this Surplus Note. This Surplus Note does not confer any rights upon the Lender, as Note Holder, other than the right to receive payment of principal and interest on the terms and subject to the conditions set forth in this Surplus Note.

2. This Surplus Note shall be repaid only out of the surplus earnings of Borrower and, as to each payment, only with the prior approval of the [State] Insurance Commissioner [of State] or his designee. Subject to the approval requirements set forth herein, Borrower at its option may repay all or any part of this Surplus Note at any time after issuance at the outstanding principal amount plus the interest accrued thereon to the date of repayment.

3. By acceptance of this Surplus Note, the Note Holder agrees that the payment of principal and interest hereunder is expressly subordinated to claims of creditors and members of Borrower, including a) policyholders of Borrower; b) claimant and beneficiary claims of policies issued by Borrower; c) all other classes of creditors other than surplus note holders; d) Operating expenses of Borrower, and e) reserve and solvency requirements as determined by applicable State law. If Borrower is dissolved and there are insufficient assets to pay in full the principal amount of and interest on all outstanding Surplus Notes, then Borrower shall pay on the Surplus Notes pro rata on the basis of the outstanding principal amount of each Surplus Note and the interest accrued thereon, unless and only to the extent that such payment is otherwise prevented, restricted or delayed by a State Solvency Payment Restriction. Regardless of the issuance date of this Surplus Note or any other surplus note of Borrower this Surplus Note shall be of equal rank with any other surplus note, unless such other surplus note is expressly subordinated to this Surplus Note.

Subject to the conditions for payment, repayment, discharge, and retirement of this Promissory Note set forth above, Borrower may, at its option, prepay this Promissory Note in whole or in part at any time without penalty.

The obligation of Borrower under this Promissory Note may not be offset or be subject to recoupment with respect to any liability or obligation owed to Borrower. No security agreement or interest, whether existing on the date of this Note or subsequently entered into, applies to the obligation under this Note.

No modification of this obligation is effective and no other agreement may modify or supersede the terms of this obligation, whether existing on the date of this Note or subsequently entered into, unless the modification or agreement is approved by the [**Insurance Commissioner**].

Borrower hereby waives the rights of presentment (meaning the right to require CMS to demand payment) and notice of dishonor (meaning the right to require CMS to give notice to other persons that amounts due hereunder have not been paid).

This Note is attached to and expressly incorporated by reference in the Loan Agreement dated **[, 2012**], as amended, supplemented or otherwise modified and in effect from time to time, the "Loan Agreement"), by and among Borrower and CMS, and evidences the "Solvency Loan" made by CMS thereunder.

The terms and conditions of the Loan Agreement are hereby incorporated in their entirety by reference as though fully set forth herein.

Address: Attention: Telephone No.: E-Mail:	[CO-OP] Per: _____ Name: Title: Date: _____